SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1936

No. 27

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

vs.

ILLINOIS LIFE INSURANCE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

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1 Before United States Board of Tax Appeals

Docket No. 67201

ILLINOIS LIFE INSURANCE COMPANY, A CORPORATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appearances:

For Taxpayer: Ray O. West, Esq., Wm. M. Klein, Esq., Samuel B. Kraus, Esq.

For Comm'r.: L. W. Creason, Esq.

Docket entries

1932

Jul. 30—Petition received and filed. Taxpayer notified. (Fee paid.)

Jul. 30—Copy of petition served on general counsel.

Sep. 26—Answer filed by general counsel.

Sep. 29—Copy of answer served on taxpayer. General Calendar.

1933

Oct. 17—Hearing set Nov. 16, 1933.

Oct. 25—Motion to amend answer, amendment tendered, filed by general counsel. 10/27/33 granted.

Nov. 16—Notice of appearance of Roy O. West, Wm. M. Klein, and Samuel Kraus, as counsel for taxpayer filed.

Nov. 16—Hearing had before Mr. Smith, Div. 5. Submitted—stipulation of facts read into record—petitioner's brief due Dec. 15, 1933—Commissioner's brief argued at hearing.

Nov. 21—Transcript of hearing of Nov. 16, 1933 filed.

Dec. 16—Order extending time to Jan. 15, 1934 to file brief and also stipulation of facts entered.

1934

Jan. 13—Motion for leave to introduce additional evidence into the record filed by taxpayer.

Jan. 13—Objections to granting of petitioner's motion filed by general counsel.

Jan. 13—Brief and argument filed by taxpayer.

Jan. 16—Motion for leave to file additional evidence denied.

2 Jul. 12—Opinion rendered, Mr. Smith. Judgment will be entered under Rule 50.

Aug. 7—Notice of settlement filed by general counsel.

Aug. 10—Hearing set August 29, 1934 on settlement.

Aug. 29—Hearing had before Mr. Smith, Div. 5 on settlement under Rule 50. Not contested—referred to Mr. Smith.

Aug. 30—Decision entered, Mr. Smith, Div. 5.

Sep. 5—Order amending decision of August 30, 1934 entered.

Nov. 7—Petition for review by U. S. Circuit Court of Appeals (7) with assignments of error filed by general counsel.

Nov. 20—Proof of service filed by general counsel.

1934.
Dec. 29—Motion for extension to Feb. 15, 1935 to complete and transmit record filed by general counsel.
Dec. 29—Order enlarging time to Feb. 15, 1934 to complete record entered.

1935
Feb. 1—Statement of evidence lodged.
Feb. 14—Motion for extension to March 13, 1935 to complete and transmit record filed by General counsel.
Feb. 14—Order enlarging time to March 13, 1935 for preparation of evidence and delivery of record entered.
Feb. 14—Notice of lodgment of statement and of hearing on Feb. 13, 1935 to approve statement filed.
Feb. 14—Praecipe with proof of service thereon filed.
Feb. 15—Notice of hearing date changed to February 20, 1935.
Feb. 20—Hearing had before Mr. Black, Div. 15 on approval of statement of evidence—not contested—referred to Mr. Smith for approval.
Feb. 20—Statement of evidence approved and ordered filed.

3 Before United States Board of Tax Appeals

[Title omitted.]

Petition

Filed July 30, 1932

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:AR:D-6 SHR-60D, dated June 2nd, 1932, and as a basis of its proceeding alleges as follows:

1. The petitioner is an Illinois corporation with its principal and Home Office at 1212 Lake Shore Drive, Chicago, Illinois.

2. The notice of deficiency, a copy of which is attached and marked "Exhibit A", was mailed to the petitioner on June 2nd, 1932.

3. The taxes in controversy are income taxes for the calendar year 1929 and for Eleven Hundred Fifteen Dollars and Twenty-five Cents ($1,115.25).

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

(a) The Commissioner of Internal Revenue erred in refusing to allow to the petitioner the full amount of depreciation claimed in its return for the taxable year in question and allowed to it by law.

(b) The Commissioner of Internal Revenue erred in refusing to allow to petitioner a depreciation allowance for the year in question, which was claimed in its return, to the same extent and identical with that allowed to other corporations not engaged in the business of life insurance, which action of the Commissioner was illegal and in violation of, and contrary to, the law under which the income tax for the

year in question was imposed and the Treasury Regulations promulgated in relation thereto.

(c) The Commissioner of Internal Revenue erred in the de-
4 termination of the deficiency in question as such determination of a deficiency under the facts of this case is without authority under the law for the year in question.

(d) The Commissioner of Internal Revenue erred in the determination of such deficiency, and is attempting to impose and levy a tax upon the petitioner which is not authorized by law.

(e) The Commissioner of Internal Revenue erred in determining the deficiency in question and is attempting to levy a greater tax upon the petitioner by reason of the fact that the petitioner possesses some income which is tax free.

(f) The Commissioner of Internal Revenue erred in limiting petitioner's depreciation allowance to 28% of the amount claimed, and in not allowing the full amount claimed by petitioner in its return.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) The petitioner is a corporation organized under the laws of Illinois, having its Home and principal office in the City of Chicago, County of Cook and State of Illinois, and is engaged in the business of issuing and writing life insurance policies on the lives of natural persons.

(b) For the taxable year in question, the petitioner sought to deduct depreciation in its return on property used in its trade and business, the following amounts on the property hereinafter described in this paragraph, viz:

Furniture & fixtures	$6,975.31
Medical information cards	5,116.43
Law books	360.46
Total	$12,452.20

(c) The respondent here subsequently allowed the depreciation claimed on law books.

(d) The respondent here refused to allow any of the depreciation claimed on medical information cards on the ground that the same were an underwriting expense pertaining solely to the production of premium income.

(e) The respondent here refused to allow the depreciation claimed by the petitioner in its return on furniture and fixtures in the amount of Six Thousand Nine Hundred Seventy-five Dollars and Thirty-one Cents ($6,975.31), and reduced the claim of petitioner in this regard to One Thousand Nine Hundred Fifty-three Dollars and Nine Cents ($1,953.09), or 28% of the amount claimed

(f) The total premium income of petitioner for the year in
5 question was Four Million Nine Hundred Seventy-five Thousand One Hundred Sixty-two Dollars and Ninety Cents ($4,975,162.90) and an investment income of One Million Nine Hundred Thirty-four Thousand Six Hundred Seventy-six Dollars and

Twenty-five Cents ($1,934,676.25), or a total income of Six Million Nine Hundred Nine Thousand Eight Hundred Thirty-nine Dollars and Fifteen Cents ($6,909,839.15).

(g) The respondent here refused to allow any depreciation on medical information cards claiming the same pertained merely to underwriting income and has limited the depreciation on furniture and fixtures to the same proportion of the amount claimed, that the investment income of petitioner for the year in question bore to the total gross income including premiums for the year in question.

(h) There is no dispute as to the rates used in computing the depreciation on such property.

Wherefore, the petitioner prays that this Board may hear the proceeding and determine that there is no deficiency in the tax of the petitioner, and that said petitioner be allowed to take its full deduction for depreciation as allowed to it by law and as claimed by it in its return for the taxable year in question, and your petitioner will ever pray.

ILLINOIS LIFE INSURANCE COMPANY, A CORP.,
By RAYMOND W. STEVENS,
President.
Address: 1212 Lake Shore Drive, Chicago, Illinois.

[*Duly sworn by Raymond W. Stevens, jurat omitted in printing.*]

6 *Exhibit A to petition*

NP–2–28
JUN—2, 1932.

IT:AR:D–6
SHR–60D
ILLINOIS LIFE INSURANCE COMPANY,
1212 Lake Shore Drive, Chicago, Illinois.

SIRS: You are advised that the determination of your tax liability for the year 1929 discloses a deficiency of $1,115.25, as shown in the statement attached.

In accordance with section 272 of the Revenue Act of 1928, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, If You Do Not Desire to Petition, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P–7. The signing of this agreement will expedite the closing of your return by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier;

Whereas If No Agreement Is Filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNETT,
Commissioner.
By (Signed) J. O. WILMER,
Deputy Commissioner.

Enclosures:
Statement
Form 882
Form 870
Schedules 1 and 2.
mrh–3

7. *Statement*

IT:AR:D–6
SHR–60D

In re: Illinois Life Insurance Company, 1212 Lake Shore Drive, Chicago, Illinois

Tax liability

Year	Tax liability	Tax assessed	Deficiency
1929	$33,450.31	$32,335.06	$1,115.25

Consent expiring December 31, 1932, except as extended by the provisions of section 277 of the Revenue Act of 1928, is on file in this office for the year 1929.

The arguments advanced at the conference held in this office with your representatives under date of May 12, 1932, with respect to depreciation on furniture, fixtures, law books, and medical information cards, have been given further consideration and in accordance with the present policy of the Bureau your contentions with the exception of depreciation on law books, cannot be allowed.

Depreciation on furniture and fixtures is held to be allowable in accordance with section 203 (a) (7) of the Revenue Act of 1928, to the extent that it is related to the earning of investment income. Since only a proportionate part of the depreciation on these assets is chargeable against investment income, this office is allowing depreciation based on the percentage which the investment income reported bears to the total gross income. Furthermore since life insurance companies are not taxed on their premium income, depreciation on furniture and fixtures is limited to the amount sustained in the earning of investment income. Adjustment of depreciation is shown in detail in schedule 1–A made a part of this letter.

With respect to the medical information cards there appears to be no reason why your company should be permitted to deduct depreciation or obsolescence upon these cards for the reason that the cards

have no connection whatever with investment income or interest, dividends and rents. The depreciation is purely an underwriting expense in connection with the investment department of your company. No depreciation is therefore considered allowable on these cards.

8 Since you have stated that the law books are used extensively in connection with foreclosure on mortgages in various states, the depreciation of the books is considered chargeable to investment income and has accordingly been allowed as a deduction.

A copy of this letter has been furnished Mr. Glenn Thompson in accordance with the authorization contained in power of attorney on file in this office.

Recomputation of the tax is shown in detail in the following schedules.

Illinois Life Insurance Company. Year ended December 31, 1929.

Schedule 1

Adjustments to net income

Net income as disclosed by return		$293,955.12
As corrected		304,093.77
Adjustment as computed below		10,138.65
Unallowable deduction and additional income:		
(a) Excessive depreciation	$10,138.65	
Net adjustment as above		10,138.65

Schedule 1-A

Explanation of items changed

(a) See statement made a part of this letter. The portion of depreciation allowable from an examination of your annual statement is approximately 28% determined as follows:

Particulars	Amount	Ratio
Total premium income (item 20, page 2, annual statement)	$4,975,162.90	72%
Investment income (item 35, annual statement)	1,934,676.25	28%
Total income, all departments	6,909,839.15	100%

The allowance of depreciation on furniture and fixtures is accordingly limited to 28% of $6,975.31 or $1,953.09.

9 Depreciation was deducted in your return as follows:

Item		*Amount*
Furniture and fixtures		$6,975.31
Medical information cards		5,116.43
Law books		360.46
Total claimed		$12,452.20
Depreciation allowable:		
Furniture and fixtures	$1,953.09	
Law books	360.46	2,313.55
Depreciation disallowed		$10,138.65

Schedule 2

Computation of tax

Net income for taxable year	$304,093.77
Income tax 11%	33,450.31
Tax previously assessed	32,335.06
Additional tax to be assessed	1,115.25

mrh-3

Before United States Board of Tax Appeals

Answer

Filed Sep. 26, 1932

Now comes the Commissioner of Internal Revenue, the respondent herein, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, and for answer to the petition heretofore filed in this appear, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegations contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4 (a) to (f), inclusive. Denies that the respondent committed the errors or any of the errors alleged in subparagraphs (a) to (f), inclusive, of paragraph 4 of the petition.

5 (a) (b) and (c). Admits the allegations contained in subparagraphs (a) (b) and (c) of paragraph 5 of the petition.

5 (d). Admits that the respondent here refused to allow any of the depreciation claimed on medical information cards. Denies the remaining allegations contained in subparagraph (d) of paragraph 5 of the petition.

5 (e) and (f). Admits the allegations contained in subparagraphs (e) and (f) of paragraph 5 of the petition.

5 (g). Admits that the respondent here refused to allow any depreciation on medical information cards. Admits that the respondent has limited the depreciation on furniture and fixtures to the same proportion of the amount claimed that the investment income of petitioner for the year in question bore to the total gross income including premiums for the year in question. Denies the remaining allegations contained in subparagraph (g) of paragraph 5 of the petition.

5 (h). Admits the allegations contained in subparagraph (h) of paragraph 5 of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore expressly admitted, qualified, or denied.

Wherefore it is prayed that the petition be denied.

(Signed) C. M. CHAREST,
General Counsel, Bureau of Internal Revenue.

Of Counsel:
L. W. CREASON,
Special Attorney,
Bureau of Internal Revenue.

11 Before United States Board of Tax Appeals

Amendment to answer

Filed Oct. 25, 1933

Now comes the Commissioner of Internal Revenue, the respondent herein, by his attorney E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, and amends his answer heretofore filed in this proceeding by adding thereto the following:

Assignments of Error

4. (g) The Commissioner committed error in not disallowing as deductions from gross income of the petitioner for 1929 the amounts of, to-wit, $131,834.86 and $1,920.85, being respectively 4 per cent of the mean of so-called "survivorship investment funds" and "additional liability on S. I. policies" for the reason that neither the so-called survivorship investment funds nor the additional liability on S. I. policies was a reserve fund required by law within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.

4. (h) The Commissioner erred in not disallowing as a deduction from gross income discount on premiums in the amount of, to-wit, $1,241.91.

Facts in Support of Respondent's Assignments of Error

5. (i) The respondent alleges on information and belief that the petitioner's liability to policyholders on account of its so-called "survivorship investment funds" on December 31, 1928, was $3,249,580.06; that it was $3,342,162.91 on December 31, 1929; that the mean of said survivorship fund during the calendar year 1929 was $3,295,871.49; that 4 per cent of said mean was $131,834.86; that the petitioner's liability on account of its so-called "additional liability on S. I. policies contingent on payment of deferred and uncollected premiums" on December 31, 1928 was $48,707.53; that it was $47,334.82 on December 31, 1929; that the mean of said additional liability on
12 said S. I. policies during the calendar year 1929 was $48,021.18; that 4 per cent of said mean was $1,920.85.

Said amounts of $131,834.86 and $1,920.85 were included in the amount of $1,276,576.57 as a deduction by the petitioner on page 1, line 11 of its income tax return for the calendar year 1929 in determining the amount reported thereon as net income. In determining the deficiency proposed in the sixty-day deficiency notice upon which the petition herein is based, the Commissioner did not disallow said amounts as deductions.

5. (j) Respondent further alleges that the petitioner included as a deduction on its income tax return for the year 1929, page 1, line 13, as "interest on indebtedness" certain discounts on premiums in the amount of, to-wit, $1,241.91, and that in determining the deficiency proposed in the sixty-day deficiency notice here involved, the Commissioner did not disallow said amount as a deduction.

Wherefore, it is prayed that the petition be denied and that the net income of this petitioner for the year 1929 as set forth in the sixty-day deficiency notice upon which the petition herein is based be increased by the amounts of, to-wit, $131,834.86, $1,920.85, and $1,241.91, and that the deficiency for that year be recomputed and redetermined accordingly.

E. Barrett Prettyman,
(Signed) E. BARRETT PRETTYMAN,
General Counsel, Bureau of Internal Revenue.

Of Counsel:
L. W. CREASON,
Special Attorney,
Bureau of Internal Revenue.

In United States Circuit Court of Appeals

Statement of evidence

Lodged Feb. 1, 1935. Filed Feb. 20, 1935

The following is a statement of all the evidence material to the assignments of error in the petition for review filed with reference to the above-entitled cause, which came on for hearing before the Honorable Charles P. Smith, member of the United States Board of Tax Appeals, on November 16, 1933. The taxpayer was represented by Samuel B. Kraus, Esq. The Commissioner was represented by E. Barrett Prettyman, Esq., General Counsel, and L. W. Creason, Esq., Special Attorney, Bureau of Internal Revenue.

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Statement of facts

All the facts relative to the questions raised in the assignments of error were stipulated at the hearing. These facts are shown in transcript of proceedings as follows:

"The petitioner is a corporation organized under the laws of Illinois having its home and principal office in the City of Chicago,

County of Cook, State of Illinois, and was during the calendar year 1929 and prior thereto engaged in the business of issuing and writing life insurance policies on the lives of natural persons.

"During and prior to the calendar year 1929 the petitioner issued certain so-called survivorship investment policies, a specimen copy of which is marked Exhibit 'A' and made a part hereof."

At this point there was received in evidence as Respondent's Exhibit A, a specimen copy of the insurance policy involving a survivorship investment policy, a copy of which is attached hereto and made a part hereof.

"Petitioner's liabilities pursuant to the agreements contained in and peculiar to said survivorship investment policies as at December 31, 1928, and as at December 31, 1929, were as follows:

	December 31, 1928	December 31, 1929
Survivorship investment funds	$3,249,580.06	$3,342,162.91
Additional liability on S. I. policies contingent on payment of deferred and uncollected premiums	48,707.53	47,334.82
Totals	3,298,287.59	3,389,497.73

"The form of the agreements referred to herein is set forth in sections headed 'Survivorship Investment Fund' and 'Optional Settlements at the End of Twenty Years.' Page 2 of Exhibit A."

Four percent of the mean of said amounts of $3,298,287.59 and $3,389,497.73, namely, $133,755.71, was included by the petitioner on its income tax return for the calendar year 1929
14 as a deduction from gross income in arriving at the amount reported taxable thereon as taxable net income. In determining the deficiency proposed in the sixty day deficiency notice, upon which the petition herein is based, the Commissioner did not disallow said amount of $133,755.71 as a deduction.

Mr. Kraus, counsel for the taxpayer, then directed the attention of the Honorable Member of the Board of Tax Appeals presiding, to the fact that the petition as originally filed related only to the deficiency first asserted by the Commissioner in the amount of $1,115.25, but the original answer to the petition was amended asserting and claiming a revised deficiency as shown thereby.

Certificate to statement of evidence

The foregoing is all of the material evidence adduced at the hearing before the Board of Tax Appeals which is material to the determination of the questions presented in the assignments of error in the petition for review, and contains all of the evidence relating to the question presented by such assignments of error adduced at

the hearing and not covered by the Board's findings of fact and the same is approved by the undersigned.

(Signed) ROBERT H. JACKSON,
Robert H. Jackson,
Assistant General Counsel for the Bureau of Internal Revenue.

Approved:

_____

Attorney for Respondent on Review.

Approved February 20, 1935:
(Sgd.) CHARLES P. SMITH,
Member, United States Board of Tax Apppeals.

Joint Exhibit A

20 Payment Life—Survivorship Investment Policy Premium payable for 20 years—Non-Participating

Amount $10,000.00. Number Specimen.

ILLINOIS LIFE INSURANCE COMPANY

Agrees to Pay Ten Thousand Dollars to Martha Priscilla Brown Wife of the Insured, or to such other beneficiary as may have been duly designated, at the Head Office of the Company, in Chicago, Illinois, immediately upon receipt of due proofs of the death of Richard Gordon Brown the Insured, of Chicago, County of Cook, State of Illinois, and of the interest of the claimant, provided that all premiums to the time of death have been duly paid.

Yearly Optional Benefits

All premiums hereon having been paid in full in cash, and this policy being free from indebtedness, the Insured, upon application made to the Head Office of the Company, on the second anniversary of its date of issue, or upon the date upon which any subsequent annual, semi-annual or quarterly premium may become due, or within thirty-one days thereafter, will be entitled to one of the following options, the respective values or extensions thereof being shown in the Tables of Values on the fourth page hereof, which said tables, with the explanation, illustration and statements prefatory thereto are a part of this policy:

First Option—Cash; to be paid upon surrender and cancellation of this policy.

Second Option—Paid-Up Insurance; to be evidenced by appropriate endorsement hereon, signed by the President or Secretary.

Third Option—Extended Insurance; which, if requested by the Insured, will be evidenced by appropriate endorsement hereon, signed by the President or Secretary.

One Month's Grace Without Interest

A grace of one month (not less than thirty days) from the due date of any premium, during which period of grace the insurance shall remain in force, will be allowed in the payment of premiums hereon during the second and subsequent policy years without interest. In case of the death of the Insured during said month, the unpaid premium shall be deducted from the proceeds hereof.

Policy Automatically Continued

Should the Insured fail to pay any premium hereon, after premiums for two years have been paid, without having exercised any one of the several options set forth on the first page hereof, the Company will, without any action on the part of the Insured, grant the Third Option (Extended Insurance) mentioned on the first page hereof.

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Reinstatement

The Company will revive and reinstate this policy at any time within five years of the date of default upon being furnished with evidence satisfactory to it of the then insurability of the Insured and payment of arrears of premiums and payment or reinstatement of any other indebtedness on this policy, with interest at the rate of five per cent per annum.

Cash Loans

The Company will make loans, charging interest in advance at six per cent per annum, on the sole security of this policy, if there has been no default in payment of premium. The loan may be for any amount which shall not exceed the Cash or Loan Value as indicated in the Tables of Values on the fourth page hereof; there is no loan value prior to the policy years for which values are shown in said Tables of Values. The Company may require a thirty days' previous notice at its Head Office before making any loan. A loan note and agreement satisfactory to the Company shall be executed and sent with the policy to the Company at its Head Office. Any indebtedness on or secured by this policy, together with any unpaid balance of the premium for, and interest in advance on the loan to the end of, the policy year in which the loan is made, shall be paid out of such loan. The whole or any part of the loan may be repaid at any time. Failure to pay any such loan, or to pay renewal interest thereon, shall not void this policy unless the total indebtedness on said policy shall equal or exceed the amount of loan available at

the time of such failure; nor until one month after notice that the policy will be liable to such forfeiture shall have been mailed by the Company to the last known address of the Insured and of any Assignee of record at the Head Office of the Company. In computing said "total indebtedness" interest if not paid when due shall be added to the principal of such loan and shall bear interest at the rate of six per cent per annum.

Suicide

Death by the Insured's own hand or act, whether sane or insane, within two years from the date hereof, is a risk not assumed by the Company, and in event of death as aforesaid, the liability of the insurer hereunder shall be limited to an amount equal to the premiums actually paid hereon.

Aviation

Death within two years from the date hereof, caused directly or indirectly by engaging in any aeronautical ascension
17 or activity, either as a passenger or otherwise, or occurring while so engaged (otherwise than in Military or Naval Service in time of war, concerning which service special conditions are made herein), is a risk not assumed by the Company, and, in the event of such death, the liability of the Company shall be limited to an amount equal to the actual premiums paid hereon.

Military or Naval Service in Time of War

Military Service, within continental United States, not involving Aeronautics, shall not affect the Company's liability under this policy, except as to such Double Indemnity and Disability Benefits, if any, as may be granted in connection with this policy.

In time of war the Insured shall not engage in or take part in any Military Service outside of continental United States, and shall not either within or without continental United States, engage in or take part in any Naval Service, nor any Aeronautic Service in connection with either Military or Naval Service. If the Insured shall die from any cause after engaging in or taking part in such prohibited service and prior to his discharge from such service or shall die within six months after such discharge, as a result, direct or indirect, of any disease or ailment contracted or injured incurred after engaging or taking part in such service and prior to discharge therefrom, the liability of the Company shall, in either event, be limited to the legal reserve hereon (American Experience 3½% basis) together with 10% of the amount which would have been payable (exclusive of benefits under Double Indemnity provisions, if any) if the Insured had not engaged in or taken part in such service; provided that the liability shall in no case exceed the amount for which the

Company would have been liable if the Insured had not engaged in or taken part in such service.

The boundaries of "continental United States" as used in this policy shall include the waters within three miles of the continental line but shall not include the Panama Canal Zone.

Travel; Residence

Travel or residence by the Insured in time of war outside of continental United States and the Dominion of Canada within a period of two years from the date hereof shall operate forthwith to limit the liability of the Company, in event of the death of the Insured thereafter occurring and within two years from the date
18 hereof, to a sum equal to the legal reserve (American Experience 3½% basis) on this policy together with 10 per cent of the face value of this policy less any indebtedness thereon. The Company will, however, issue a Permit for such travel or residence (but not granting Double Indemnity or Disability Benefits in the case of policies in which provision is made for any such benefit), upon payment of the required extra premium at its Head Office prior to the departure of the Insured from continental United States or Canada (but no Permit shall be issued which will make the total liability of the Company on any one life exceed five thousand dollars [$5,000] together with the legal reserve calculated as hereinbefore stipulated on any insurance in excess of said sum). Any Permit issued will be for a limited period and renewable only upon payment of the extra premium required for such renewal at the time thereof.

Change of Beneficiary

The Insured may, without expense, at any time, and from time to time, during the continuance of this policy, provided it is not then assigned, change the beneficiary, or beneficiaries, by written notice to the Company, at its Head Office, accompanied by this policy, such change to take effect only upon endorsement of the same on the policy by the Company. If no beneficiary or beneficaries hereunder according to the most recent appointment of the Insured shall be living at the death of the Insured; the amount then insured by this policy shall be paid to the estate of the Insured.

Premiums, Where and How Payable

All premiums hereon are due and payable in advance at the Head Office of the Company in Chicago, Illinois, but may be paid to duly authorized collectors of the Company, in advance, in exchange for the Company's official receipt, signed by the President or Secretary, and countersigned by the collector. A premium other than an annual will be accepted according to the Table of Payments endorsed hereon and made a part hereof; provided that the receipt of any such pre-

mium, less than a full annual, shall not have the effect to continue this policy in force longer than three months in case of a quarterly premium, or six months in case of a semi-annual premium. Notice of every premium that may become due or payable hereunder is given and accepted by the delivery and acceptance of this policy, and any further notice is expressly waived by the Insured. Failure to pay any premium when due shall, except as herein otherwise provided, void this policy and forfeit all premiums paid hereon to the Company, and terminate and forfeit the Insured's right to pay any further premiums hereunder.

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Instalment Option

The Insured may at any time, provided this policy is not then assigned, change the manner of payment of the insurance hereunder from one payment to payment in Limited Annual Instalments or in Continuous Annual Instalments in accordance with and subject to the provisions headed "Instalment Benefits" and the appropriate table thereunder. Such change will take effect upon endorsement of the same on the policy by the Company.

Survivorship Investment Fund

The company guarantees that it will set aside, from each full year's premium paid to the Company after the first and to and including the twentieth, on account of this policy, the amount set forth as the Annual Contribution at the bottom of the Table of Payments on the fourth page hereof. The amounts so set aside shall be placed in a fund to be known as "The Survivorship Investment Fund", applicable to policies on the Survivorship Investment Plan issued in the same calendar year as this policy. The Company agrees that no deductions shall be made from said fund for any purpose whatsoever but that all contributions to said fund shall be accumulated at the rate of three and one-half per cent per annum, compound interest from the dates of the respective payments. The Company further agrees to apportion to this policy, as a Survivorship Investment, provided the Insured hereunder shall survive to the twentieth anniversary of the date hereof and that all premiums hereon have been paid, and not otherwise, a sum bearing the same proportion to the total amount of said fund as the total contributions thereto from premiums paid on this policy bear to the aggregate total contributions thereto from premiums paid on all policies in the Survivorship Investment Class issued in the same calendar year as this policy and that are in force at the end of twenty years from their respective dates of issue, and on which all premiums have been duly paid. For the purpose of this provision a premium waived under Disability Provisions shall be held and construed as a premium paid.

The Company will furnish the Insured hereunder, upon his written request after this policy shall have been in force more
20 than three years, a statement of the amount of this policy's proportionate share of the Survivorship Investment Fund then accumulated and held awaiting apportionment, without deduction, at the expiration of the Survivorship Investment Period.

Optional Settlements at the End of Twenty Years

A. The Insured may continue this policy as a Fully Paid-up policy, no further payment of premiums being required, and receive in addition thereto:

1. A cash payment of the Survivorship Investment hereto apportioned; or

2. A Fully Paid-up Non-Participating Life Policy, subject to satisfactory evidence of insurability, for such amount as will be purchased by the Survivorship Investment hereto apportioned, at the Company's then published single premium rate applicable at the then attained age of the insured; or

B. The Insured may surrender this policy and receive:

3. A cash payment of the Entire Cash Value, namely: the Guaranteed Cash Surrender Value of $6,100.00, and in addition thereto the Survivorship Investment hereto apportioned.

Note.—At the expiration of the Survivorship Investment Period, a statement will be rendered the Insured, setting forth the values of the above settlements. If the Insured fails to exercise his option to elect one of the aforesaid settlements, and to notify the Company thereof in writing at its Head Office within three months from the end of the Survivorship Investment Period, it is agreed that Settlement No. 1 shall automatically apply.

(In right-hand margin:) See copy of Application herewith and if errors or omissions are found therein, note the same and return the policy to "Illinois Life Insurance Company, Chicago, Ill.", for correction.

General Provisions

(1) This policy and the application therefor, a copy of which is hereto attached, taken together, constitute the entire contract, which cannot be varied, except by the President or Secretary of the Company, in writing, and no condition, privilege, provision, or modification of this contract endorsed hereon, or attached hereto, shall control or be binding upon the Company, or in any manner regarded as a part of this contract, unless the same bears the signature (or facsimile thereof) of the President or Secretary
21 and is countersigned by the Recorder or Assistant Recorder. (2) All statements made by the Insured shall, in the absence of fraud, be deemed representations and not warranties, and no such statement shall avoid this policy unless it is contained in the written application, copy of which is attached hereto. (3) If

the age of the Insured is misstated, the amount payable under this policy shall be such as the actual premium paid would have purchased at the correct age of the Insured, and all benefits under this policy, including the term of Extended Insurance, as set forth in the Tables of Values shall be modified to correspond to the correct amount of this policy and to the correct age of the Insured, in accordance with the Company's published tables of rates and values in use at the date of the issue hereof. (4) Upon the maturity of this policy by the death of the Insured, any unpaid balance of the annual premium for the current insurance year, together with any and all other indebtedness hereon, or secured hereby, shall be a first lien on this policy, and will be deducted and set off against any amount becoming due hereon. (5) The Tables of Values on the fourth page hereof apply only to policies free from indebtedness. On policies subject to indebtedness the benefits shown in said Tables of Values shall be reduced in the following manner: Any indebtedness, including any loan made on the security of this policy, shall first be deducted from the net reserve value of the benefit applied for (if application be duly made), or of the benefit automatically available (if application be not duly made), the respective benefits indicated by said tables being proportionately reduced in the case of Surrender for Cash or of Paid-up Insurance; in case of Extended Insurance the net reserve value reduced as aforesaid shall be applied as a net single premium on the American Experience 3½ per cent basis to purchase extended insurance for a sum equal to the face amount of the policy reduced by the amount of the indebtedness and interest. (6) The failure to pay any premium hereon when due, or the maturity of this policy by death or otherwise, shall render any loan hereon forthwith due and payable. (7) Any assignment of this policy must be made in duplicate and both copies sent to the Head Office, one to be retained by the Company and the other to be returned. The Company assumes no responsibility for the validity of any assignment. (8) No suit shall be brought or maintained to collect under this policy unless commenced within six years from the time the cause of action accrues. (9) This policy is not entitled to participate in the profits or surplus of the Company. (10) The
22 Insured may, without the consent of the beneficiary, receive every benefit, exercise every right and enjoy every privilege conferred upon the Insured by this policy, and enter into any agreement or contract with the Company respecting modification or termination of this policy. (11) The reserve on this policy shall be computed on the American Experience Table of Mortality with interest at 3½% per annum, according to the Illinois standard of valuation, except that after the 20th year, if premiums for 20 full years have been paid, the reserve shall be computed on the same Table of Mortality with interest at 3% per annum.

This policy shall be incontestable after it shall have been in force, during the lifetime of the Insured, for two years from its date,

except for non-payment of premiums, and subject to the provisions of the paragraph in this policy headed "Military or Naval Service in Time of War", and except as to provisions and conditions (if any) relating to benefits in event of total and permanent disability and those granting additional insurance specifically against death by accident.

This Agreement is Made in Consideration of the written and printed application therefor, which is hereby made a part hereof, and of the payment of the Premium on the dates and during the period set forth in the Schedule below. The first year's insurance under this policy is term insurance purchased by the whole or a part of the premium to be received during the first policy year.

Schedule

How Premium Is to Be Payable			Period During Which Premium Is Payable and Amount Thereof	
Annually	Day	Month	Period	Amount of Premium
in advance on the following dates of each year:	1	October	First Twenty Years.....	Three Hundred Seventy-nine and 90/100 Dollars.
			After Twenty Years.....	None.

In witness Whereof, the Illinois Life Insurance Company has caused this agreement to be signed by its President and Secretary, and countersigned by its Recorder or Assistant Recorder this first day of October One Thousand Nine Hundred and Thirty-one.

RAYMOND W. STEVENS,
(Signature deleted)
President.

BERT J. STOOKEY,
(Signature deleted)
Secretary.

——— ———, *Recorder.*

23 Specimen Copy Examined by

Instalment Benefits

The Insured may, at any time and from time to time, if the policy has not been assigned, and upon the terms and conditions hereinafter stated, change the mode of settlement of the proceeds of this policy from payment in one sum to payment in equivalent annual instalments, in accordance with the tables shown below, and thereafter may revoke such change (again making the proceeds payable in one sum), or may select some other of the modes of settlement designated below. The payment of the first instalment shall be made immediately upon receipt of due proofs of the death of the

Insured and of the interest of the claimant, and subsequent instalments shall be paid annually thereafter.

The commutation, in every case where permitted as above, or required as hereafter stated, shall be on the basis of three and one-half per cent interest, computed annually.

Each change in the mode of settlement, or revocation thereof, must be requested by the Insured in writing, and shall not take effect until endorsed on this policy by the Company at its Head Office.

The beneficiary shall not be permitted either to assign or commute any unpaid instalments, unless such right is given the beneficiary by the Insured, in writing, and is endorsed on this policy by the Company at its Head Office during the lifetime of the Insured.

Notwithstanding an Instalment Benefit shall have been granted hereunder, instalments shall be commuted and paid in a single sum in the cases hereinafter mentioned, to-wit:

(1) No instalments shall be paid hereunder if the same would be less than Forty Dollars ($40.00) each; but in any such case the Commuted Value of such instalments shall be paid in one sum at the maturity of the policy.

(2) Any part of the proce'ds of the policy payable to the executor, administrator, or assignee of the Insured shall be commuted and paid in one sum.

(3) If any beneficiary shall die after having received one or more instalments hereunder, the Commuted Value of the instalments then remaining unpaid shall be paid in one sum to the executors or administrators of the beneficiary.

24 The following tables are based upon a policy the proceeds of which, payable in a single sum, are One Thousand Dollars and will apply pro rata to this policy.

Table of Limited Annual Instalments

Annual Instalments limited to the number stated below; any number from two to twenty-five may be selected by the Insured.

Number of Instalments	25	*20	19	18	17	16	15	14	13	12
Amount of each Instalment	$58	$68	$70	$73	$76	$79	$83	$88	$93	$100
Number of Instalments	11	10	9	8	7	6	5	4	3	2
Amount of each Instalment	$107	$116	$127	$140	$157	$181	$214	$263	$344	$507

* Illustration.—If payment is to be made by twenty Annual Instalments, the amount of each Instalmen will be $68 for each $1,000 of proceeds.

Table of Continuous Annual Instalments

Annual Instalments to continue during entire lifetime of beneficiary, but Twenty-five Annual Instalments at least to be paid. (Pay-

ment by Continuous Instalments cannot be selected if there is more than one beneficiary under this policy.)

Age of Beneficiary at Death of Insured	15 or under	16	17	18	19	20	21	22	23	24
Amount of each Instalment	$43	$43	$43	$43	$44	$44	$44	$44	$45	$45
Age of Beneficiary at Death of Insured	25	26	27	28	29	30	31	32	33	34
Amount of each Instalment	$45	$45	$46	$46	$46	$47	$47	$47	$48	$48
Age of Beneficiary at Death of Insured	35	36	37	38	39	40	41	42	43	44
Amount of each Instalment	$49	$49	$49	$50	$50	$51	$51	$52	$52	$53
Age of Beneficiary at Death of Insured	45	46	47	48	49	*50	51	52	53	54
Amount of each Instalment	$53	$53	$54	$54	$55	$55	$55	$56	$56	$56
Age of Beneficiary at Death of Insured	55	56	57	58	59	60	61	62	63	64 or over
Amount of each Instalment	$57	$57	$57	$57	$58	$58	$58	$58	$58	$58

* Illustration.—If at the death of the Insured the beneficiary should be 50 years of age last birthday, the amount of each Annual Instalment will be $55.00 for each $1,000 of proceeds, and on a policy the proceeds of which were $10,000, the amount of each Annual Instalment would be $550.00, the payment of instalments to continue during the entire lifetime of the beneficiary; if, however, the beneficiary should die before twenty-five instalments shall have been paid, the remainder of said twenty-five instalments will be commuted and paid in one sum, as stated above.

25 Blank Spaces for Head Office Endorsements Only

No. Specimen
Amount $10,000.00
Richard Gordon Brown
Illinois Life
Insurance Company
Head Office, Chicago, Illinois
20 Payment Life
Survivorship Investment Policy
Premiums Payable for 20 Years
Non-Participating

Premiums on this Policy may be paid annually, semi-annually, or quarterly, at the option of the Insured, according to the following:

Table of payments

Annual Premium	*$379.90
Due 1st of October in advance	
Semi-Annual Premium	$197.60
Due 1st of October and April in advance	
Quarterly Premium	$100.70
Due 1st of October, January, April, and July in advance	
Annual contribution from said Premiums (2nd to 20th years), as herein provided, to S. I. Fund	
$64.60	

Ta

Blank Spaces For

[Applicable to this policy, if free from indebte

EXPLANATION: The Cash Loan Value for each $1,000 of this policy is the amount shown in TABLE 1 below, in indicating the number of full years' premiums paid hereon.

The amounts of the Cash Surrender Value and of the Paid-up Insurance Value for each $1,000 of this policy, ar respectively, in the column designating the age, marked with an asterisk, at which this policy is issued and oppos quarter in the third or any subsequent policy year) a proportionate allowance will be made in computing benefits

ILLUSTRATI : The Paid-Up Insurance Value available on each $1,000 of a policy issued at age 35 after paymen $463.00 or $1,157.50.

TABLE 1.

[Based on a Policy of $1,000. Cash Va

Years Premiums Paid	★	Age at wh									
		15	16	17	18	19	20	21	22	23	2
2		$13	$13	$14	$14	$14	$14	$14	$14	$15	
3		26	26	27	27	28	28	28	29	29	
4		38	39	40	41	42	42	43	43	44	
5		52	53	54	55	56	57	58	59	60	
6		69	70	71	73	74	76	77	79	80	
7		86	88	90	92	94	96	97	99	102	
8		105	107	109	112	114	117	119	121	124	
9		125	127	130	133	135	138	141	144	147	
10		145	148	151	154	158	161	164	167	171	
11		166	169	173	176	180	183	187	191	195	
12		187	191	195	199	203	207	211	215	219	
13		210	214	218	222	227	229	236	240	245	
14		233	237	242	247	252	257	262	267	272	
15		257	262	267	272	278	283	289	294	301	
16		282	288	293	299	305	311	317	323	330	
17		308	315	320	327	333	340	346	353	361	
18		336	343	349	356	363	370	377	385	392	
19		364	371	378	385	393	401	409	417	426	
20		419	427	435	443	451	459	468	476	485	

TABLE 2. *Paid-*

[Based o

Years Premiums Paid		Age at wh									
		15	16	17	18	19	20	21	22	23	2
2		$41	$41	$41	$40	$40	$40	$40	$40	$40	
3		78	78	78	78	78	78	78	79	79	
4		115	115	115	116	117	117	118	118	118	
5		153	154	154	155	156	156	157	157	158	
6		200	202	203	206	207	209	212	213	214	
7		259	261	262	265	266	268	271	272	273	
8		319	321	322	325	326	328	330	331	332	
9		379	381	382	384	386	388	389	390	391	
10		440	441	442	444	446	448	449	450	451	
11		501	502	503	505	506	508	509	510	511	
12		562	563	564	565	567	568	569	570	571	
13		624	625	625	626	628	629	629	630	631	
14		686	687	687	688	689	690	690	691	691	
15		749	749	749	749	751	751	751	751	752	
16		811	812	811	811	812	812	812	812	813	
17		875	875	873	873	874	874	873	873	872	
18		938	938	936	936	936	936	934	934	933	
19		999	999	996	996	996	996	996	995	994	
20		1000	1000	1000	1000	1000	1000	1000	1000	1000	10

TABLE 3. *Extended ins*

Years Premiums Paid		Age at wh									
		15	16	17	18	19	20	21	22	23	
	Yrs. Mo.	*Yrs. Mo.*	*Yrs. Mo.*	*Yrs. Mo.*	*Yrs. Mo.*	*Yrs. Mo.*	*Yrs. Mo.*	*Yrs. Mo.*	*Yrs. Mo.*	*Yrs. Mo.*	*Yr*
2		1 6	1 6	1 6	1 6	1 7	1 7	1 8	1 8	1 8	

Tables of Values

Blank Spaces For Head Office Endorsements Only

[Applicable to this policy, if free from indebtedness, under the conditions specified in the policy]

EXPLANATION: The Cash Loan Value for each $1,000 of this policy is the amount shown in TABLE 1 below, in the column under the age, marked with an asterisk, at which the policy is issued and opposite the number in the first column indicating the number of full years' premiums paid hereon.

The amounts of the Cash Surrender Value and of the Paid-up Insurance Value for each $1,000 of this policy, and the term of Extended Insurance from the original due date of the unpaid premium, are shown in TABLES 1, 2, and 3 below, respectively, in the column designating the age, marked with an asterisk, at which this policy is issued and opposite the number indicating the full years for which premiums have been paid. At intervening periods (i. e., at the end of any quarter in the third or any subsequent policy year) a proportionate allowance will be made in computing benefits for any fractional portion of a year's premium paid.

ILLUSTRATION: The Paid-Up Insurance Value available on each $1,000 of a policy issued at age 35 after payment of premiums for 10 full years is $463.00. The Paid-Up Insurance Value, therefore, on a policy of $2,500 would be 2½ times $463.00 or $1,157.50.

TABLE 1. *Cash and loan values*

[Based on a Policy of $1,000. Cash Values at end of Year; Loan Values any time during Year]

Years Premiums Paid	Age at which policy is issued ★																					Years Premiums Paid
	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	
2	$13	$13	$14	$14	$14	$14	$14	$14	$15	$15	$15	$16	$16	$16	$16	$17	$17	$17	$18	$18	$19	2
3	26	26	27	27	28	28	28	29	29	30	30	31	32	32	33	34	34	35	36	36	37	3
4	38	39	40	41	42	42	43	43	44	45	46	47	48	49	50	51	52	53	54	55	56	4
5	52	53	54	55	56	57	58	59	60	61	62	64	65	66	68	69	70	72	73	75	77	5
6	69	70	71	73	74	76	77	79	80	82	84	86	88	90	93	95	97	99	102	104	107	6
7	86	88	90	92	94	96	97	99	102	104	106	109	111	114	116	119	122	125	128	131	134	7
8	105	107	109	112	114	117	119	121	124	127	129	132	135	138	141	145	148	151	155	158	162	8
9	125	127	130	133	135	138	141	144	147	150	153	157	160	164	167	171	175	179	183	187	191	9
10	145	148	151	154	158	161	164	167	171	174	178	182	186	190	194	198	203	207	212	219	221	10
11	166	169	173	176	180	183	187	191	195	199	203	207	212	216	221	226	231	236	241	246	251	11
12	187	191	195	199	203	207	211	215	219	224	229	234	239	244	249	254	260	265	271	277	283	12
13	210	214	218	222	227	229	236	240	245	250	256	261	267	272	278	284	290	296	303	309	316	13
14	233	237	242	247	252	257	262	267	272	278	284	290	296	302	309	315	322	329	336	343	350	14
15	257	262	267	272	278	283	289	294	301	307	313	320	326	333	340	347	355	362	370	377	385	15
16	282	288	293	299	305	311	317	323	330	337	344	351	358	366	373	381	389	397	406	414	422	16
17	308	315	320	327	333	340	346	353	361	368	375	383	391	399	408	416	424	433	442	451	460	17
18	336	343	349	356	363	370	377	385	392	400	409	417	426	434	443	452	462	471	481	490	500	18
19	364	371	378	385	393	401	409	417	426	434	443	452	462	471	481	490	500	511	521	531	541	19
20	419	427	435	443	451	459	468	476	485	495	504	514	524	534	544	555	565	576	587	598	610	20

TABLE 2. *Paid-up insurance values*

[Based on a Policy of $1,000]

Years Premiums Paid	Age at which policy is issued																					Years Premiums Paid
	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	
2	$41	$41	$41	$40	$40	$40	$40	$40	$40	$40	$41	$41	$41	$41	$41	$41	$41	$41	$41	$41	$41	2
3	78	78	78	78	78	78	78	79	79	79	80	80	80	81	81	81	82	82	82	82	83	3
4	115	115	115	116	117	117	118	118	118	119	120	120	120	121	121	121	122	122	123	123	124	4
5	153	154	154	155	156	156	157	157	158	158	159	159	160	162	164	166	168	170	171	172	173	5
6	200	202	203	206	207	209	212	213	214	215	217	219	220	221	222	224	226	227	229	230	231	6
7	259	261	262	265	266	268	271	272	273	274	276	278	279	280	282	283	285	286	287	288	289	7
8	319	321	322	325	326	328	330	331	332	333	335	337	339	340	341	342	343	344	345	346	347	8
9	379	381	382	384	386	388	389	390	391	392	394	396	398	399	400	401	402	403	404	405	405	9
10	440	441	442	444	446	448	449	450	451	452	454	456	457	458	459	460	461	462	462	463	463	10
11	501	502	503	505	506	508	509	510	511	512	514	515	516	517	518	519	519	520	520	520	520	11
12	562	563	564	565	567	568	569	570	571	572	574	575	576	576	577	577	577	577	577	577	577	12
13	624	625	625	626	628	629	629	630	631	632	634	634	634	635	635	635	635	635	636	635	634	13
14	686	687	687	688	689	690	690	691	691	692	693	693	693	693	693	693	693	692	692	692	691	14
15	749	749	749	749	751	751	751	751	752	752	752	752	752	751	751	751	750	750	749	749	748	15
16	811	812	811	811	812	812	812	812	813	812	812	812	811	811	810	810	809	808	807	806	806	16
17	875	875	873	873	874	874	873	873	872	872	872	871	871	870	869	868	867	866	865	864	862	17
18	938	938	936	936	936	936	934	934	933	933	932	931	930	929	928	926	925	924	923	921	919	18
19	999	999	996	996	996	996	996	995	994	993	992	991	990	988	986	984	983	981	979	977	975	19
20	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	20

TABLE 3. *Extended insurance for face amount of policy*

Years Premiums Paid	Age at which policy is issued																					Years Premiums Paid
	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	
	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	
2	1 6	1 6	1 6	1 6	1 7	1 7	1 8	1 8	1 8	1 9	1 9	1 9	1 9	1 9	1 9	1 10	1 10	1 10	1 10	1 10	1 10	2
3	2 9	3 1	3 2	3 2	3 2	3 2	3 3	3 3	3 4	3 4	3 5	3 5										

2		$13	$13	$14	$14	$14	$14	$14	$14	$15	$15	$15	$16	$16	$16	$16	$17	$17	$17	$18	$18	$19	2
3		26	26	27	27	28	28	28	29	29	30	30	31	32	32	33	34	34	35	36	36	37	3
4		38	39	40	41	42	42	43	43	44	45	46	47	48	49	50	51	52	53	54	55	56	4
5		52	53	54	55	56	57	58	59	60	61	62	64	65	66	68	69	70	72	73	75	77	5
6		69	70	71	73	74	76	77	79	80	82	84	86	88	90	93	95	97	99	102	104	107	6
7		86	88	90	92	94	96	97	99	102	104	106	109	111	114	116	119	122	125	128	131	134	7
8		105	107	109	112	114	117	119	121	124	127	129	132	135	138	141	145	148	151	155	158	162	8
9		125	127	130	133	135	138	141	144	147	150	153	157	160	164	167	171	175	179	183	187	191	9
10		145	148	151	154	158	161	164	167	171	174	178	182	186	190	194	198	203	207	212	216	221	10
11		166	169	173	176	180	183	187	191	195	199	203	207	212	216	221	226	231	236	241	246	251	11
12		187	191	195	199	203	207	211	215	219	224	229	234	239	244	249	254	260	265	271	277	283	12
13		210	214	218	222	227	229	236	240	245	250	256	261	267	272	278	284	290	296	302	309	315	13
14		233	237	242	247	252	257	262	267	272	278	284	290	296	302	309	315	322	329	335	343	350	14
15		257	262	267	272	278	283	289	294	301	307	313	320	326	333	340	347	355	363	370	377	385	15
16		282	288	293	299	305	311	317	323	330	337	344	351	358	366	373	381	389	397	406	414	422	16
17		308	315	320	327	333	340	346	353	361	368	375	383	391	399	408	416	424	433	442	451	460	17
18		336	343	349	356	363	370	377	385	392	400	409	417	426	434	443	452	462	471	481	490	500	18
19		364	371	378	385	393	401	409	417	426	434	443	452	462	471	481	490	500	511	521	531	541	19
20		419	427	435	443	451	459	468	476	485	495	504	514	524	534	544	555	565	576	587	598	610	20

TABLE 2. *Paid-up insurance values*

[Based on a Policy of $1,000]

Years Premiums Paid	Age at which policy is issued																					Years Premiums Paid
	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	
2	$41	$41	$41	$40	$40	$40	$40	$40	$40	$40	$41	$41	$41	$41	$41	$41	$41	$41	$41	$41	$41	2
3	78	78	78	78	78	78	78	79	79	79	80	80	80	81	81	81	82	82	82	82	82	3
4	115	115	115	116	117	117	118	118	118	119	120	120	120	121	121	121	122	122	123	123	124	4
5	153	154	154	155	156	156	157	157	158	158	159	159	160	162	164	166	168	170	171	172	173	5
6	200	202	203	206	207	209	212	213	214	215	217	219	220	221	222	224	226	227	229	230	231	6
7	259	261	262	265	266	268	271	272	273	274	276	278	279	280	282	283	285	286	287	288	289	7
8	319	321	322	325	326	328	330	331	332	333	335	337	339	340	341	342	343	344	345	346	347	8
9	379	381	382	384	386	388	389	390	391	392	394	396	398	399	400	401	402	403	404	405	405	9
10	440	441	442	444	446	448	449	450	451	452	454	456	457	458	459	460	461	462	462	463	463	10
11	501	502	503	505	506	508	509	510	511	512	514	515	516	517	518	519	519	520	520	520	520	11
12	562	563	564	565	567	568	569	570	571	572	574	575	575	576	576	577	577	577	577	577	577	12
13	624	625	625	626	628	629	629	630	631	632	634	634	634	635	635	635	635	635	636	635	634	13
14	686	687	687	688	689	690	690	691	691	692	693	693	693	693	693	693	693	692	692	692	691	14
15	749	749	749	749	751	751	751	751	752	752	752	752	752	751	751	751	750	750	749	749	749	15
16	811	812	811	811	812	812	812	812	813	812	812	812	811	811	810	810	809	808	807	806	806	16
17	875	875	873	873	874	874	873	873	872	872	872	871	871	870	869	868	867	866	865	864	862	17
18	938	938	936	936	936	936	934	934	933	933	932	931	930	929	928	926	925	924	923	921	919	18
19	999	999	996	996	996	996	996	995	994	993	992	991	990	988	986	984	983	981	979	977	975	19
20	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	1000	20

TABLE 3. *Extended insurance for face amount of policy*

Years Premiums Paid	Age at which policy is issued																					Years Premiums Paid
	15	16	17	18	19	20	21	22	23	24	25	26	27	28	29	30	31	32	33	34	35	
	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.	Yrs. Mo.		
2	1 6	1 6	1 6	1 6	1 7	1 7	1 8	1 8	1 8	1 9	1 9	1 9	1 9	1 9	1 9	1 10	1 10	1 10	1 10	1 10	1 10	2
3	3 0	3 1	3 2	3 2	3 2	3 2	3 3	3 3	3 4	3 4	3 5	3 5	3 5	3 5	3 6	3 6	3 6	3 6	3 7	3 7	3 7	3
4	4 7	4 8	4 9	4 10	4 10	4 11	5 0	5 1	5 2	5 3	5 4	5 4	5 5	5 6	5 7	5 7	5 8	5 8	5 9	5 10	5 11	4
5	6 4	6 5	6 6	6 7	6 8	6 9	7 1	7 2	7 3	7 5	7 7	7 8	7 9	7 10	7 11	8 1	8 3	8 4	8 5	8 5	8 6	5
6	8 9	8 11	9 2	9 4	9 6	9 8	9 10	10 0	10 2	10 4	10 5	10 7	10 8	10 9	10 10	10 11	10 11	10 11	10 11	10 10	10 9	6
7	12 0	12 3	12 6	12 8	12 10	13 1	13 3	13 5	13 7	13 9	13 10	13 11	14 0	14 0	13 11	13 10	13 9	13 7	13 5	13 3	13 0	7
8	15 5	15 11	16 3	16 5	16 7	16 9	16 11	17 0	17 1	17 2	17 2	17 2	17 1	17 0	16 11	16 9	16 7	16 4	16 0	15 9	15 5	8
9	19 9	20 0	20 3	20 4	20 5	20 6	20 7	20 7	20 7	20 6	20 4	20 2	20 0	19 9	19 6	19 2	18 10	18 6	18 1	17 8	17 3	9
10	24 0	24 2	24 4	24 3	24 3	24 2	24 0	23 10	23 8	23 5	23 2	22 10	22 6	22 2	21 9	21 4	20 11	20 6	20 0	19 6	18 11	10
11	28 1	28 1	27 11	27 9	27 7	27 4	27 1	26 9	26 5	26 0	25 7	25 2	24 9	24 3	23 9	23 3	22 8	22 1	21 6	20 11	20 4	11
12	31 9	31 6	31 2	30 10	30 6	30 1	29 8	29 2	28 9	28 3	27 9	27 2	26 7	26 0	25 5	24 10	24 3	23 8	23 0	22 4	21 8	12
13	34 11	34 8	34 0	33 6	32 6	31 11	31 5	30 10	30 2	29 7	29 0	28 4	27 8	27 0	26 4	25 8	25 0	24 3	23 6	22 9	22 1	13
14	37 7	37 1	36 5	35 10	35 3	34 8	34 0	33 4	32 8	32 0	31 3	30 7	29 10	29 2	28 5	27 8	26 11	26 2	25 5	24 8	23 11	14
15	40 1	39 5	38 8	38 0	37 4	36 8	35 11	35 5	34 11	34 1	33 3	32 6	31 8	30 11	30 0	29 0	28 3	27 5	26 7	25 10	25 0	15
16	42 6	41 9	40 11	40 2	39 5	38 8	37 10	37 1	36 4	35 6	34 8	33 10	33 0	32 2	31 4	30 6	29 8	28 10	28 0	27 2	26 3	16
17	45 1	44 3	43 3	42 7	41 10	40 11	40 1	39 3	38 5	37 7	36 8	35 10	35 0	34 1	33 2	32 3	31 5	30 6	29 7	28 8	27 9	17
18	47 8	47 0	46 0	45 0	44 0	43 1	42 2	41 3	40 4	39 4	38 5	37 6	36 6	35 6	34 6	33 7	32 8	31 8	30 8	29 8	28 8	18
19	50 2	49 0	48 0	47 0	46 0	45 0	44 0	43 1	42 1	41 2	40 3	39 4	38 5	37 6	36 7	35 8	34 9	33 10	32 11	32 0	31 1	19
20	For Life	For Life	For Life	For Life	For Life	For Life	For Life	For Life	For Life	For Life	For Life	For Life	For Life	For Life	For Life	For Life	For Life	For Life	For Life	For Life	For Life	20

The Loan and Surrender Values prior to the 20th year are the equivalent of the Reserve reduced by a sum not exceeding 2½% of the amount insured; and for the 20th and subsequent years such values are the equivalent of the Reserve without such deduction. The Reserve above mentioned does not include any reserve maintained on account of Accident and Disability Benefits. The Cash Surrender Values at all times are at least equal to the reserve value of the Extended Insurance and of the Paid-up Insurance.

29 Before United States Board of Tax Appeals

Promulgated July 12, 1934

1. The furniture and fixtures of the petitioner were used in both its investment and underwriting business. Held, that the petitioner is entitled to deduct from gross income only the amount of the depreciation sustained upon the furniture and fixtures used in its investment business.

2. The petitioner purchased annually from the Medical Inspection Bureau certain medical information cards which it claimed had a useful life of approximately 10 years. In its tax return it deducted from gross income an amount representing the obsolescence upon these cards. Since these cards were used exclusively in its underwriting, it is held that the amount is not a legal deduction from gross income.

3. The petitioner issued 20-payment life insurance policies which provided that a portion of each premium payment should be set aside in a "survivorship investment fund", to be accumulated at interest and distributed to surviving persistent policyholders of the class after 20 years. Held, that the fund constituted a reserve required by law, upon which the petitioner is entitled to a 4 percent reserve deduction.

4. In its income tax return the petitioner deducted $1,240.91 as interest paid on indebtedness. The amount represented discounts on premiums. Held, that the amount is not a legal deduction from gross income.

Samuel B. Kraus, Esq., for the petitioner.

L. W. Creason, Esq., for the respondent.

Opinion

Filed July 12, 1934

SMITH: This is a proceeding for the redetermination of a deficiency in income tax for 1929 of $1,115.25. The petitioner alleges that the respondent erred in disallowing the deduction from gross income of (1) a portion of the depreciation sustained by it upon its furniture and fixtures; (2) an amount claimed as depreciation upon certain medical information cards; and by an amended answer the respondent alleges that he erred (3) in not excluding from the company's reserve funds the mean of a "survivorship investment
30 fund" and that through his failure to do so the petitioner has erroneously been allowed a deduction of $133,755.71 in the computation of the deficiency; and (4) that the respondent erroneously failed to disallow the deduction from gross income of $1,241.91 representing discounts on premiums claimed in the return "as interest on indebtedness." The respondent has moved to increase the deficiency accordingly.

The petitioner is an Illinois corporation which has its home and principal office in Chicago. During the calendar year 1929 and prior thereto it was engaged in the business of issuing and writing life insurance policies on the life of individuals.

Issue No. 1

During the year 1929 the petitioner owned and used in its business certain furniture and fixtures which it had acquired between 1921 and 1929 and for which it had paid $69,753.19. Its purchases of such assets in 1929 amounted to $5,635.78. The useful life of these assets was approximately ten years. They were used by the petitioner in both its investment and underwriting business and their use in connection with the investment department of its business, producing the statutory income designated interest, dividends, and rents, amounted to 28 percent of their use for all purposes. The remaining 72 percent of use was in connection with the production of the petitioner's non-statutory or underwriting income.

The petitioner included in deductions from gross income reported on its income tax return for the calendar year 1929 the amount of $6,975.31 as depreciation on furniture and fixtures, which amount represented 10 percent of the cost of all the furniture and fixtures owned. In determining the deficiency upon which this proceeding is based the respondent allowed only $1,953.09 of the amount so deducted by the petitioner, being 10 percent of the cost of that portion of the furniture and fixtures which was used in the production of statutory income; that is, income from interest, dividends, and rents. The petitioner claims the deduction of the full amount of $6,975.31.

This issue is decided in favor of the respondent upon the authority of Rockford Life Ins. Co. v. Commissioner, — U. S. — (May 21, 1934). The depreciation deduction as to purchases in 1929 is subject to adjustment in accordance with the respondent's regulations; they were not owned for a full year.

31 Issue No. 2.

During the calendar year 1929 petitioner owned certain so-called medical information cards which had been acquired at a cost of $51,164.27 during the years 1921 to 1929, inclusive. The amount expended in the year 1929 was $7,517.06. The medical information cards were individual cards. Each card contained a code report of the physical disabilities found upon examination of individuals applying for insurance to life insurance companies which purchased such cards from the Medical Inspection Bureau. Each life insurance company which purchased these cards made a report of the physical impairments found upon the examination of the applicants. The cards were replaced from time to time if and when later examinations of the same individuals were made. Such of the cards as were not

otherwise replaced within a period of approximately ten years were removed from the files or destroyed.

The petitioner included in the deductions from gross income reported on its income tax return for 1929 the amount of $5,116.43 as depreciation or obsolescence of such medical information cards, being 10 percent of the total cost thereof. In determining the deficiency proposed in the 60-day deficiency notice upon which the computation herein is based the respondent disallowed the deduction of this amount of $5,116.43.

All of the medical information cards hereinabove referred to were used exclusively in the production of nonstatutory or underwriting income and no part of these cards was used in the production of petitioner's statutory net income; that is, income from interest, dividends, and rents. We sustain the action of the respondent in disallowing the deduction of the $5,116.43 in question. *Rockford Life Ins. Co.* v. *Commissioner*, *supra*.

Issue No. 3.

During and prior to the calendar year 1929 the petitioner issued certain so-called survivorship investment policies. A specimen copy of a "20-Payment Life Survivorship Investment Policy" was introduced in evidence as Joint Exhibit A. The provisions of this policy relative to the survivorship investment feature are that upon such policies the petitioner sets aside a portion of each premium payment which is placed in the "survivorship investment fund."
32 This fund is accumulated at the rate of 3½ percent per annum compound interest from the dates of the respective payments of premiums. At the expiration of the 20-year life of the policy the insured has the option of continuing the policy as a fully paid-up policy without further premiums, and receiving in addition a cash payment of the survivorship investment apportioned to his policy or a fully paid nonparticipating life policy for such amount as will be purchased by the survivorship investment at the applicable single premium rate, or the policyholder may surrender the policy and receive in cash the entire guaranteed cash surrender value plus the portion of the survivorship investment fund apportioned to his policy. For each calendar year there is a different survivorship class. The survivorship investment fund can not be used except for the payment of survivorship benefits and at the end of 20 years the entire fund in the class maturing in that year is to be distributed among all the members in good standing in the class in proportion to their respective contributions to the fund established for that class.

In determining net income, life insurance companies are authorized by section 203 (a) (2) of the Revenue Act of 1928 to deduct from gross income "An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subsection [tax-free interest], of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year."

The survivorship investment funds at the beginning and end of the taxable year of the petitioner were as follows:

	December 31, 1928	December 31, 1929
"Survivorship investment funds"	$3,249,580.06	$3,342,162.91
"Additional liability on S. I. policies contingent on payment of deferred and uncollected premiums"	48,707.53	47,334.82
Total	3,298,287.59	3,389,497.73

In its income tax return for 1929 the petitioner deducted from gross income $133,755.71 representing 4 percent of the mean of the "survivorship investment funds" at the beginning and end of the year 1929.

The sole question arising upon this issue is whether the re-
33 serve funds above described were "reserve funds required by law." The petitioner was organized and operated under the laws of the State of Illinois. In 1929 its operations were governed by an act approved May 20, 1907, in force January 1, 1908, and officially printed in the Session Laws of 1907, page 367. . This act is also contained in Cahill's Illinois Revised Statutes (1929), chapter 73, commencing at paragraph 375. Section 1 of the act provides in part as follows:

"Sec. 1. That from and after January 1, 1908, no policy of life insurance shall be issued or delivered in this State or be issued by a life insurance company organized under the laws of this State, unless the same shall provide the following:

* * * * * * *

"(5–c) The provisions of the preceding paragraphs numbered (5–a) and (5–b) of this section shall not apply to any form of paid-up insurance or temporary insurance or pure endowment insurance, issued or granted in exchange for lapsed or surrendered policies, or to nonparticipating policies: Provided, however, that if any company shall issue any nonparticipating policy under the terms of which any stipulated part of premiums received is to be placed in a separate fund for subsequent apportionment, such company shall furnish the Department of Trade and Commerce each year a statement showing the number and amount of all such policies in force at the beginning of the year for which the statement is made; of all such policies issued and revived or terminted during the said year with the mode of termination; and the number and amount of all of such policies in force at the end of saidyear. Also a statement showing any and all amounts provisionally set apart, ascertained or calculated or held awaiting apportionment upon such policies according to classes, at the beginning of said year, the additions made to the said fund during the year with the source from which such additions arose, the deductions made from the said fund (if permitted by the contract) during the year with the reasons therefor and the amount of said fund at the end of the year; which shall be

carried as a distinct and separate reserve liability of the company for the benefit of the classes of policies from the premium payments on which the sum was accumulated. No part of said fund
34 prior to the time of distribution stipulated in the contract, shall be considered in determining the loan and cash and other surrender values provided for by this Act. * * *"

It is to be observed that paragraph (5–c) of section 1 of the above cited act applies to precisely the type of policy introduced in Joint Exhibit A and that the portions of the premiums allocated to the "survivorship investment fund" are expressly required to "be carried as a distinct and separate reserve liability of the company for the benefit of the classes of policies from the premium payments on which the sum was accumulated."

In Standard Life Ins. Co. of America, 13 B. T. A. 13; affd., 47 Fed. (2d) 218, we set forth at length what constitutes the reserve funds of a life insurance company. In short the reserve funds required by law of a life insurance company are those funds which the company must, pursuant to statute, maintain as a reserve upon the valuation of the policies. The outstanding policies are valued according to their terms as of a particular date and the sum total of such valuations constitutes the reserve funds. Such reserve funds are exclusive of certain liabilities which the company may have and which may be required to be shown in their annual statements. Massachusetts Mutual Life Ins. Co. v. United States, 56 Fed. (2d) 897; United States v. Boston Ins. Co., 269 U. S. 197.

There can be no question in the present case but that the "survivorship investment fund" maintained by the petitioner was a reserve fund required by law. Nor can there be any question but that such a fund constitutes a policy reserve. It constituted a part of the fund that the petitioner was required to have on hand to meet its policy obligations at the end of the 20-year premium payment period. We sustain the petitioner's contention upon this issue. See Missouri State Life Ins. Co., 29 B. T. A. 401; Standard Life Ins. Co. of America, supra; Commissioner v. Western Union Life Ins. Co., 61 Fed. (2d) 207; Reserve Loan Life Ins. Co., 18 B. T. A. 359.

Issue No. 4

The petitioner included as a deduction on its income tax return for 1929 as "interest on indebtedness" certain discounts on premiums in the amount of $1,241.91. In determining the deficiency proposed in the 60-day deficiency notice upon which the petition herein is
35 based the respondent did not disallow said amount as a deduction. He now alleges that he erred in failing to make such disallowance.

In its brief the petitioner does not question the correctness of the respondent's contention upon this issue.

The contention of the respondent is sustained. The evidence fails to show that the $1,241.91 was interest "paid or accrued within the taxable year on its indebtedness" within the meaning of section 203 (a) (8) of the Revenue Act of 1928.

Reviewed by the Board. Judgment will be entered under Rule 50.
Trammell concurs in the result.
Black, Marquette, Morris, and Leech dissent.

Before the United States Board of Tax Appeals

Decision

Entered Aug. 30, 1934

Pursuant to the opinion of the Board in the above-entitled proceeding promulgated July 12, 1934, the respondent, on August 7, 1934, filed with the Board a notice of settlement. Hearing was had thereon on August 29, 1934, at which time there was no appearance for the petitioner and the notice of settlement filed by the respondent was not contested. Wherefore, it is

Ordered and Decided that there is an unpaid assessment to be abated, in the amount of $14,713.24.

[SEAL] (S.) CHARLES P. SMITH, *Member.*

Entered August 30, 1934.

36 Before United States Board of Tax Appeals

Order amending decision

Entered Sept. 5, 1934

For good cause shown of record, it is—

Ordered that the decision of the Board in the above-entitled proceeding entered August 30, 1934, be and the same is hereby amended by striking therefrom the last paragraph and by substituting therefor the following:

Ordered and Decided as follows:

1929

Tax assessed:		
Original, Account #403798		$32,335.06
Additional, March 1933, 21C, #4		15,964.99
Total		48,300.05
Tax paid (Form 899):		
March 17, 1930	$8,088.77	
June 13, 1930	8,078.76	
September 15, 1930	8,078.77	
December 15, 1930	8,088.76	
Total tax paid		32,335.06
Difference		15,964.99
Correct tax liability	$33,586.81	
Tax paid	32,335.06	
Unpaid portion of tax liability		1,251.75
Unpaid assessment to be abated		14,713.24

[SEAL] (S.) EUGENE BLACK, *Member.*

Dated: September 4, 1934.

Entered September 5, 1934.

37 In United States Circuit Court of Appeals for the Seventh Circuit

[Title omitted.]

Notice of filing petition for review

Filed Nov. 20, 1934

To:

Mr. ABEL DAVIS, *Receiver,*
% Illinois Life Insurance Company,
SAMUEL B. KRAUS, Esq.,
% West and Eckhart,
First National Bank Building, Chicago, Illinois.

(Stamped:) Received Nov. 20, 1934, U. S. Board of Tax Appeals.

You are hereby notified that the Commissioner of Internal Revenue did, on the 7th day of November 1934, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Seventh Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

(Signed) ROBERT H. JACKSON,
Assistant General Counsel for the
Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein, is hereby acknowledged this 10th day of November 1934.

(Signed) ABEL DAVIS,
Receiver for Respondent on Review.
By CHESTER A. DAVIS,
(Signed) SAMUEL B. KRAUS,
Attorney for Respondent on Review.

38 In United States Circuit Court of Appeals

Petition for review to the United States Circuit Court of Appeals for the Seventh Circuit

Filed Nov. 7, 1934

To the Honorable Judges of the Circuit Court of Appeals for the Seventh Circuit:

Comes now Guy T. Helvering, Commissioner of Internal Revenue, by his attorneys, Frank J. Wideman, Assistant Attorney General, Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, and Hugh R. Dowling, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I

The petitioner on review (hereinafter referred to as the Commissioner), is the duly appointed, qualified, and acting Commissioner of Internal Revenue of the United States, appointed and holding his office by virtue of the laws of the United States. The respondent on review (hereinafter referred to as the taxpayer), is a corporation, which at all times material herein, had its principal place of business and principal office at 1212 Lake Shore Drive, Chicago, Illinois, and said corporation at all times material herein made its returns of income to the Collector of Internal Revenue, Chicago, Illinois, all of which is within the jurisdiction of the United States Circuit Court of Appeals for the Seventh Circuit.

II

The matter in controversy involves the liability of the taxpayer for income taxes for the taxable year 1929 in the amount of $14,713.24, imposed under the pertinent provisions of the Revenue Act of 1928.

III

In reporting its income for 1929 the taxpayer failed to in-
39 clude a sum amounting to 4% of the mean of certain survivorship investment funds and other similar funds on hand at December 31, 1928, and December 31, 1929. By affirmative allegation in the pleadings before the Board of Tax Appeals, counsel for the Commissioner added this sum, (amounting to $133,755.71) to taxpayer's income for the reason that that amount did not constitute a deduction allowed by law.

In its opinion issued on July 12, 1934, the Board of Tax Appeals held that the sum in question was a part of a fund which the taxpayer was required by law to have on hand to meet its policy obligations at the end of the twenty-year premium payment period and was, therefore, a policy reserve deductible from income. The final decision of the Board in accordance with its opinion was issued on August 30, 1934. On September 5, 1934, an order amending the decision was issued, which, however, did not affect the result reached in the decision previously issued, but merely set forth more clearly the manner in which the recomputation of the deficiency was made.

IV

A review by the United States Circuit Court of Appeals for the Seventh Circuit is sought herein of said decision by the United States Board of Tax Appeals.

V

The Commissioner says that in the decision and the final orders of redetermination rendered and entered by the Board, manifest errors

occurred and intervened to the prejudice of the Commissioner, and the Commissioner assigns the following errors and each of them, which he avers occurred in said record, proceedings, finds of fact, decision and final order of redetermination, and upon which he relies as grounds for the reversal of said decision and final order of redetermination so rendered and entered by the Board of Tax Appeals, to-wit:

1. In finding as an ultimate fact that at the expiration of the twenty-year life of the specified insurance policy, the insured is entitled to receive a fully paid non-participating life policy for such amount as will be purchased by the survivorship investment at the applicable single premium rate.

2. In finding as an ultimate fact that the funds set aside by the taxpayer upon which the amount in question was based, were reserve funds required by the laws of the State of Illinois.

3. In failing to find that the amount of $133,755.71 representing 4% of the mean of the amounts in the survivorship and related funds at the beginning and end of the year 1929 was taxable as income to the petitioner.

4. In holding that the amount of $133,755.71 referred to in the preceding paragraph constituted a deduction allowed by law.

5. In holding as a matter of law that because the sum of $133,755.71 was a part of reserve funds required by law, it was for this reason exempt from Federal income taxation.

6. In failing to find the petitioner liable for additional income tax in the amount of $14,713.24.

Wherefore, the Commissioner petitions that the decision and final order of the United States Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Seventh Circuit, and that a transcript of the record be prepared in accordance with the law and the rules of said Court and be transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

(Signed) FRANK J. WIDEMAN,
Assistant Attorney General.
(Signed) ROBERT H. JACKSON,
Assistant General Counsel for the Bureau of Internal Revenue.

Of Counsel:
J. R. JOHNSTON,
HUGH R. DOWLING,
Special Attorneys,
Bureau of Internal Revenue.

[*Duly sworn to by Hugh R. Dowling; jurat omitted in printing.*]

41 Before United States Board of Tax Appeals

Order enlarging time

Entered Dec. 29, 1934

On motion of counsel for the petitioner, it is

Ordered: That the time for preparation of the evidence and transmission and delivery of the record sur petition for review of the above entitled proceeding by the United States Circuit Court of Appeals, Seventh Circuit, be and it is hereby extended to February 15, 1935.

[SEAL] (Signed) EUGENE BLACK, *Member.*

Dated Washington, D. C., December 29, 1934.

Now, February 28, 1935, the foregoing order enlarging time certified from the record as a true copy.

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

42 Before United States Board of Tax Appeals

Order enlarging time

Entered Feb. 14, 1935

On motion of counsel for the petitioner, it is

Ordered that the time for preparation of the evidence and for transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit be and it is hereby extended to March 13, 1935.

Dated: Washington, D. C., Feb. 14, 1935.

[SEAL] (Signed) EUGENE BLACK, *Member.*

Now, February 28, 1935, the foregoing order enlarging time certified from the record as a true copy.

B. D. GAMBLE,
Clerk, U. S. Board of Tax Appeals.

In United States Circuit Court of Appeals

Praecipe for record

Filed Feb. 14, 1935

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, copies duly certified as correct of the following documents and records in the above-entitled cause in connection with the petition for review by the said Circuit Court of Appeals for the Seventh Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of the proceedings before the Board.
2. Pleadings before the Board.

(a) Petition, including annexed copy of deficiency letter.

(b) Answer and Amendment to Answer filed September 26, 1932 and October 25, 1933, respectively.

3. Opinion of the Board promulgated July 12, 1934, and
43 decisions of the Board dated respectively August 30, 1934 and September 5, 1934.

4. Petition for review, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

5. Statement of the evidence as settled and allowed.

6. Order enlarging time for the preparation of the evidence and the transmission and delivery of the record not included in record.

7. This Praecipe.

(Signed) ROBERT H. JACKSON,
Assistant General Counsel for the Bureau of Internal Revenue.
(Sd.) ABEL DAVIS,
Receiver for Illinois Life Ins. Co.
By CHESTER R. DAVIS.

Service of a copy of the within praecipe is hereby admitted this 4 day of February, 1935.

(Sd.) SAMUEL B. KRAUS,
Attorney for Respondent.

[Clerks, Certificates to foregoing transcript omitted in printing.]

45 [Caption omitted.]

[Minute entry of argument and submission, Nov. 6, 1935, omitted in printing.]

46 In United States Circuit Court of Appeals for the Seventh Circuit

No. 5469. October Term and Session, 1935

COMMISSIONER OF INTERNAL REVENUE, PETITIONER,
vs.
ILLINOIS LIFE INSURANCE COMPANY, RESPONDENT

On Petition for Review of the Decision of the United States Board of Tax Appeals

Before EVANS and ALSCHULER, Circuit Judges, and LINDLEY, District Judge

Opinion

Filed November 26, 1935

LINDLEY, District Judge: The Revenue Act of 1928, c. 852, 45 Stat. 791, Section 203, provides that net income of life insurance companies shall include gross income, less, among other items, "4 per centum

of the mean of the reserve funds required by law and held at the beginning and end of the taxable year. * * *" In pursuance of this provision, in reporting its income, the respondent deducted from its gross income for the year 1929, 4 per cent of the mean of a reserve carried by it, in accordance with the Illinois statute, termed "survivorship investment fund." The Commissioner disallowed the deduction and assessed an additional tax. The Board of Tax Appeals allowed the deduction. The Commissioner now petitions to review the Board's decision. The sole question involved is whether or not the "survivorship investment fund" of respondent is "a reserve fund required by law" within the meaning of the act of Congress.

47 Respondent is an Illinois life insurance corporation. During the taxable year it issued "survivorship investment" policies, which provide that the company will set aside a specific portion of each premium payment and place the same in the fund under consideration. This fund accumulates by the addition of 3½ per cent per annum compound interest from the dates of the respective payments. At the expiration of the twenty year period of a policy the insured, if living, has the option to continue it as fully paid up without further premium payments and receive in addition thereto payment in cash of the survivorship investment thereto apportioned; or to receive a paid-up non-participating life policy, for such amount as can be purchased by the survivorship investment fund at the applicable single premium rate; or to surrender the policy and receive its cash surrender value, plus the portion of the survivorship investment fund apportioned to the policy. If the insured dies prior to the expiration of the twenty year period, his beneficiary receives the face value of his policy but no part of the investment fund. In such case his contingent interest in the latter lapses in favor of those of the same class who survive the period.

The Illinois Statute provides that if any company shall issue any policy under the terms of which stipulated parts of the premiums are to be placed in a separate fund for subsequent apportionment "same shall be carried as a distinct reserve liability of the company for the benefit of the classes of policies, * * * on which the sum was accumulated." It is further provided that no part of such fund, prior to the time of distribution provided in the policy, shall be considered in determining the surrender values of the policy provided for by the act.

The Supreme Court of the United States in the case of Helvering, Commissioner of Internal Revenue v. Inter-Mountain Life Insurance Company, 294 U. S. 686, because of the conflict in various circuits as disclosed by certain cases (Commissioner v. Standard Life Ins. Co. (C. C. A. 3), 47 F. (2d) 218; Commissioner v. Western Union Life Ins. Co. (C. C. A. 9) 61 F. (2d) 207; Commissioner v. Great American Life Ins. Co. (C. C. A. 10), 70 F. (2d) 133; Continental Assur. Co. v. United States, 8 F. Supp. 474; Cf. Minnesota Mutual Life Ins. Co. v. United States, 66 Ct. Cls. 481; Massachusetts Mutual

Life Ins. Co. v. United States, 56 F. (2d) 897), granted certiorari in a case involving the question of whether reserves against matured but unpaid coupons attached to a policy are within the meaning
48 of the Revenue Act. By the terms of the policy the company agreed to accept the coupons involved in payment of premiums or to pay them in cash at any time after maturity, with interest. The Court held that the liability upon such coupons was not contingent but matured, unconditional and absolute, payable in cash or its equivalent, saying:

"In life insurance the reserve means the amount, accumulated by the company out of premium payments which is attributable to and represents the value of the life insurance elements of the policy contracts. * * * Life insurance matures only upon the death of the insured and the life reserve is based upon that contingency, whereas liability on the matured coupons depends upon no contingency. It follows that the insurance reserves alone constitute the base on which the deduction is to be computed. Reserves against matured coupons are excluded."

It is apparent from the language that the determining element was the fact that the matured coupons no longer represented contingent liabilities.

It is contended by petitioner that the survivorship investment fund here involved is like that involved in the case cited. But we find what, we think, are essential distinctions. Here, there is no matured liability; and there can be none unless the insured shall survive the maturity of his policy. That contingency is uncertain; it may or may not occur; and unless it occurs, the insured has no right to participate in the fund. Whether the company will ever become indebted to the insured, therefore, is contingent and uncertain. Furthermore, the amount payable remains uncertain and undeterminable until the first contingency shall have been removed. It is not possible to determine until the end of the period of the policy whether the insured will ever participate in the fund, or, if he does survive, what the amount of his participation will be.

These facts, it seems to us, effectively distinguish matured liabilities upon coupons, non-contingent in character, from the contingent liabilities protected by the survivorship investment fund.

It is said that the words of the Supreme Court in the Inter-Mountain case defining life insurance reserves are to be construed strictly and that we must eliminate from deductible reserves all funds
49 that are not within the original and elemental meaning of life insurance. In this connection respondent also relies upon the decision of the Court of Claims in Minnesota Mutual Life Insurance Company v. The United States, 66 Ct. of Cls. 481; certiorari denied. 279 U. S. 856, wherein the court held that all accumulated undistributed cash surrender funds are in the nature of savings deposits, not strictly life insurance, and, therefore, not within contemplation of Congress when it used the term "reserves required by law." If

we are to limit our conception of life insurance to the narrow class of sums payable in case of death, we shall thereby remove from reserves, it seems to us, all sums accumulated in any reserves payable in case of survivorship. Strictly speaking, perhaps, life insurance does not necessarily include guaranteed cash surrender values. Rather, if we speak literally, life insurance probably includes only policies of insurance, the provision of which is that in case of death, while the policy is in full force and effect, the face thereof shall be paid. But as insurance has developed, life insurance has come to mean more than mere payment of losses in case of death. It has come to include cash surrender values, guaranteed loan values, dividend, endowment, and tontine funds and other similar variations of the original insurance contract, brought into existence and embodied in insurance contracts to protect the insured, not only in case of death but, also, in case of survivorship. All cash surrender values, guaranteed loan values, tontine, endowment, and dividend payments are payable, not because of death, but because of investment of premiums for the benefit of an insured who has survived; and if we begin to eliminate such of these funds as represent the accumulation of investment of premiums, in the end we shall be compelled logically to eliminate all of them and also to limit our definition of "reserves required by law" to such reserves only as are created as a fund against the payment of death claims. This we do not believe was the intent of Congress; nor do we believe that the Supreme Court intended such construction of the statutory language in the Inter-Mountain case. In Maryland Casualty Co. v. United States, 251 U. S. 342, in discussing reserves, the Court said:

"The term 'reserve' or 'reserves' has a special meaning in the law of insurance. While its scope varies under different laws, in general it means a sum of money, variously computed or estimated, which, with accretions from interest, is set aside, 'reserved', as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, future unaccrued and contingent claims, and claims accrued, but contingent and indefinite as to amount or time of payment."

In the later case, U. S. v. Boston Ins. Co., 269 U. S. 197, the Court modified this conclusion by eliminating the last class, "claims accrued, but contingent and indefinite as to amount or time of payment"; but it did not restrict further its previous announcement. So, here, we have an investment survivorship fund which, in the language of the Supreme Court, "is set aside, reserved, as a fund with which to mature or liquidate either by payment or reinsurance * * * future unaccrued and contingent claims." It follows that if this definition of "reserve" is followed, then the fund which provides against future contingent claims of an unknown class of survivors for unknown amounts is a legitimate part of the "reserves" which Congress had in mind.

We prefer to believe that all life insurance in its essential attributes is not a mere gambling contract, against the contingent stake of which reserves are maintained, but rather an investment program under the terms of which "The members pay premiums which when invested would, if the member lived exactly the average life, produce the sum agreed to be paid. Those who do not reach the expected age gain, those who exceed the age lose, but in the long run there cannot be either gain or loss. The policy-holder takes his chances of being a gainer or loser, but the fundamental idea is investment." Eckersley v. Federal L. Insur. Co., 2 OntWN 1274, 19 OntWR 507, 508. Another expression of the same idea is found in 37 C. J. 360, as follows:

"Life insurance is not a means of raising wealth, but in its most usual form is simply a mode of putting by money for savings, and in this sense is an investment of money."

And this is the view quite generally adopted in this country, a typical statement being that in Logan v. Fidelity, etc. Ins. Co., 146 Mo. 114; 47 S. W. 948, reading thus:

"The mere addition of one or more features or elements in a contract of insurance on life, that may serve to give the contract or policy a particular designation in the business or insurance world, will not in the least divest the contract or policy of its chief character, of insurance on life, or make the contract other than life insurance."

51 Life insurance today is not limited to policies for the payment of losses in case of death. Thus we have endowment insurance, the validity of which has long been recognized (Briggs v. McCullough, 36 Calif. 542); and in some jurisdictions, similar thereto, tontine or semi-tontine insurance policies the latter of which the present policy is an example (37 Corpus Juris 363; Gourley v. Northwestern Nat. Life Ins. Co., 94 Okla, 46; Uhlam v. N. Y. Life Ins. Co., 109 N. Y. 421). This class of insurance, which includes a provision for the payment of a specific sum upon death and in addition provisions for payment of accumulated funds upon survivorship of the tontine period, is not essentially different from endowment insurance. The variance is one of degree only. That the amount payable under the endowment plan will be paid is certain at all times, but under the tontine plan, that event is contingent upon survivorship. That contracts of endowment or tontine character, where recognized by statute, are properly insurance contracts is apparent from the decisions. The enlargement of the term, life insurance, is dwelt upon in Briggs v. McCullough, 36 Calif. 542, where the Court says that the covenant to pay a sum at the expiration of a certain period does not divest the contract of its character of life insurance. To the same effect holdings concerning endowment provisions are, Endowment and Benevolent Association v. State, 35 Kansas 253; Rothschild v. New York Life Insurance Co., 97 Ill. App. 547; Townsend v. Equitable Life Society, 263 Ill. 432.

The liability under all policies, until it is determined to whom the payments are to be made and in what sum they shall be made, is contingent. Thus in Cooley's Briefs on Insurance (2nd. Ed. 1927) it is said:

"Until the expiration of the tontine period, the liability of the company is contingent. (Avery v. Equitable Life Insur. Soc., 117 N. Y. 459, 23 N. E. 3). On the expiration of the period, the relation of debtor and creditor arises."

In Avery v. Equitable Life Assurance Society, 117 N. Y. 451, the Court said:

"The character of such policies is described * * * as involving the amount of the fund, out of which the dividend shall be paid to the surviving holder, in uncertainty, and, hence, creating a liability on the part of the company to him under such a
52 policy, which was necessarily contingent and could only be determined when, at the end of the dividend period, the aggregate of the fund from accretions, interest, etc., could be ascertained for division among the survivors."

The Supreme Court in Duffy v. Mutual Benefit Co., 272 U. S. 613, said:

"Until the maturity of a policy, the policyholder is simply a member of the corporation, with no present enforceable right against the assets. Upon the maturity of the policy he becomes a creditor with an enforceable right. Then for the first time there is an indebtedness."

In the Inter-Mountain case the Court found that the holders had become creditors, all coupons having matured, and that there was a matured obligation and indebtedness. This position was entirely consistent with that of the Court in its previous holdings in McCoach v. Insurance Co., 244 U. S. 585 and other cases, wherein it held reserves against matured unpaid losses not within the meaning of regular reserves. The basis of the prior opinions was the fact that the loss had occurred, the policy matured and the indebtedness thereon ripened into maturity. There was no longer any contingency, but a presently existing liability—an indebtedness no longer within the protection of regular reserves for contingent liabilities.

We conclude that the funds in the present instance were a special reserve, under a proper insurance contract, intended for the protection of contingent liabilities and within the meaning of reserves of life insurance companies as intended by Congress and as defined by the Supreme Court.

Accordingly the decision of the Board of Tax Appeals is Affirmed.

53. In United States Circuit Court of Appeals

5469

COMMISSIONER OF INTERNAL REVENUE

vs.

ILLINOIS LIFE INSURANCE COMPANY

Petition for Review of Decision of the United States Board of Tax Appeals

Judgment

Nov. 26, 1935

This cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof; It is now here ordered and adjudged by this court that the decision entered in this cause on August 30, 1934, by the United States Board of Tax Appeals, be, and the same is hereby affirmed.

Recital as to petition for rehearing and answer thereto

And afterwards, to wit: On the sixteenth day of December 1935, there was filed in the office of the Clerk of this court a petition for rehearing, which said petition for rehearing is not copied here.

And afterwards, to wit: On the twenty-sixth day of December 1935, there was filed in the office of the Clerk of this court an answer to the petition for rehearing, which said answer to the petition for rehearing is not copied here.

53 In United States Circuit Court of Appeals

Title omitted

Order denying petition for rehearing

Jan. 9, 1936

It is ordered by the court that the petition for a rehearing in this cause be, and the same is hereby denied.

Clerk's certificate to foregoing transcript omitted in printing.

56 Supreme Court of the United States

Order allowing certiorari

Filed May 18, 1936

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(Endorsement on cover:) File No. 40457. U. S. Circuit Court of Appeals, Seventh Circuit. Term No. 27. Guy T. Helvering, Commissioner of Internal Revenue, petitioner, *vs.* Illinois Life Insurance Company. Petition for a writ of certiorari and exhibit thereto. Filed April 7, 1936. Term No. 27 O. T. 1936.

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In the Supreme Court of the United States

OCTOBER TERM, 1935

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ILLINOIS LIFE INSURANCE COMPANY

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit entered in the above case on November 26, 1935, affirming a decision of the United States Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 29) is reported in 30 B. T. A. 1160. The opinion of the Circuit Court of Appeals is reported in 80 F. (2d) 280.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on November 26, 1935. The petition for rehearing was denied on January 9, 1936. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether amounts held by respondent, a life insurance company, at the beginning and end of the calendar year 1929, on account of so-called "survivorship investment funds" and additional liability on survivorship investment policies contingent on payment of deferred and uncollected premiums, constituted "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.[1]

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved will be found in the Appendix, *infra,* pp. 13–16.

STATEMENT

Respondent is an Illinois corporation, which, during the calendar year 1929 and prior thereto, was engaged in the business of writing and issuing

[1] Section 203 (a) (2) of the Revenue Act of 1928, c. 852, 45 Stat. 791, re-enacts without substantial change the corresponding provisions of Section 245 (a) (2) of the Revenue Acts of 1921, c. 136, 42 Stat. 227; 1924, c. 234, 43 Stat. 253; and 1926, c. 27, 44 Stat. 9.

policies of life insurance on the lives of individuals, with its home office and place of business in the city of Chicago, Illinois. (R. 13.) During and prior to the calendar year 1929, respondent issued certain so-called survivorship investment policies of life insurance, designated "20 Payment Life—Survivorship Investment Policy", a specimen copy being set forth in the record as "Joint Exhibit A." (R. 13, 14–27.) This policy calls for the payment of an annual premium of $379.90, out of which there is set aside each year (from the second to the twentieth years) the sum of $64.60 in the "survivorship investment fund." (R. 25.) This fund is accumulated at the rate of 3½ percent compound interest from the dates of the respective premium payments, and the company agrees that no deductions shall be made from said fund for any purpose whatsoever. (R. 19.) At the end of twenty years the entire survivorship investment fund in the class of policies maturing in that year is to be distributed among the members of the class *then surviving* and in good standing in proportion to their respective contributions to the fund established for that class. (See Survivorship Investment Fund (R. 19).)

At the expiration of the twenty-year life of the policy, the insured has the option of (R. 20):

> (a) Continuing his policy as a fully paid-up policy without the payment of further premiums and of receiving *in addition thereto*—

(1) A cash payment of the survivorship investment *then* apportioned to his policy, or

(2) Subject to satisfactory evidence of his then insurability, a Fully Paid-up Non-Participating Life Policy, for such amount as could be then purchased by the survivorship investment, at the company's then published single premium rate applicable at the *then* attained age of the insured; or

(b) Surrender his policy and receive—

(3) In cash the cash surrender value of his policy of $6,100, and *in addition thereto* the survivorship investment then apportioned to his policy.

After notice to the insured, if he fails to notify the company of his election within three months from the end of the survivorship investment period, optional settlement No. 1 automatically applies. (Optional Settlements (R. 20).)

Respondent's liabilities pursuant to the agreements contained in and peculiar to said survivorship policies as of December 31, 1928, and as of December 31, 1929, were as follows:

	Dec. 31, 1928	Dec. 31, 1929
Survivorship investment funds	$3,249,580.06	$3,342,162.91
Additional liability on S. I. policies contingent on payment of deferred and uncollected premiums	48,707.53	47,334.82
Total	3,298,287.59	3,389,497.73

(See Statement of Evidence (R. 13).)

Respondent in its income tax return for the calendar year 1929 claimed and took as a deduction from its gross income 4 percent of the mean of the above totals, that is, $133,755.71. (R. 13.)

The Board of Tax Appeals, four members of the Board dissenting (R. 35), sustained the respondent, holding that the amounts held at the beginning and end of the calendar year 1929, above set forth, constituted "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928, and thereupon entered its decision in favor of respondent on the issue here involved. (R. 31–35.) The Circuit Court of Appeals affirmed the Board's decision and denied the Commissioner's petition for review.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that a fixed liability, which might in the future be converted into life insurance at the option of a policyholder but which had not been so converted during the tax year, is one against which a technical insurance reserve such as is contemplated by Section 203 (a) (2) of the Revenue Act of 1928, may be set up and maintained.

2. In holding that the survivorship investment fund with accumulations thereon held at the beginning and end of the calendar year 1929 constituted "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.

3. In holding that respondent's liability on account of survivorship investment funds and additional liability on account of survivorship investment policies contingent on payment of deferred and uncollected premiums, against which respondent held so-called reserves at the beginning and end of the calendar year 1929, constitute "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.

4. In holding that the legal reserves required to be maintained by respondent during the year 1929 under the laws of the State of Illinois included the amounts set aside by respondent in its survivorship investment fund, with accumulations thereon, and respondent's liabilities on survivorship investment policies contingent on the payment of deferred and uncollected premiums.

5. In failing to hold that the survivorship investment fund held by respondent, with accumulations thereon, at the beginning and end of the calendar year 1929 to meet its liabilities to the holders of its outstanding 20 Payment Life Survivorship Investment Policies did not constitute "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.

6. In failing to hold that the amount held by respondent at the beginning and end of the calendar year 1929 to meet its additional liability on survivorship investment policies contingent on payment of deferred and uncollected premiums did not con-

stitute "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.

7. In failing to hold that the "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928 and the laws of the State of Illinois are only those held against life insurance in force and unmatured.

8. In affirming the decision of the Board of Tax Appeals and denying the Commissioner's petition for review.

REASONS FOR GRANTING THE WRIT

1. The decision below is in direct conflict with the decision of this Court in *Helvering* v. *Inter-Mountain Life Ins. Co.*, 294 U. S. 686.

In the case at bar the only question is whether the "survivorship investment fund" set aside by the respondent, and the fund held to cover "additional liability on survivorship investment policies" are "reserve funds" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928. The Government submits that since neither fund is designed to pay life insurance, these funds are not "reserve funds."

The survivorship investment fund is set aside exclusively to pay contributors to a tontine plan. Payments from that fund are made on a principle which is the very reverse of life insurance, for they are made to those who survive, and not to the bene-

ficiaries of those who die. These payments may be made in cash. Or they may, if the survivor so elects (and if he is a satisfactory insurance risk), be made in the form of a paid-up insurance policy. But until the survivor elects, it is clear that the respondent company holds the fund as a reserve not to meet a liability for life insurance policies, but as a reserve to meet its liability to pay survivors of a tontine plan either cash or a premium on a life insurance policy.

The fund held to cover "additional liability on S. I. [survivorship investment] policies contingent on payment of deferred and uncollected premiums" (R. 13) is manifestly a mere liability of the company. It is not a life insurance reserve, because there are in existence no life insurance policies which it could cover.

In holding that these funds are insurance reserve funds required by law, the lower court has rendered a decision in direct conflict with *Helvering* v. *Inter-Mountain Life Ins. Co.*, 294 U. S. 686. In that case this Court held that a fund set aside by a life insurance company as a reserve for matured and unpaid coupons attached to 20-payment life coupon nonparticipating policies did not constitute a reserve fund required by law within the meaning of Section 245 (a) (2) of the Revenue Act of 1921 (which is identical with the provision of the Revenue Act of 1928 here invoked). Mr. Justice Butler pointed out (page 690) that:

The word "reserve" has many meanings. Accounts creating reserves are set up in almost every line of business, and funds evidenced by the book entries are held for many and widely different purposes. As the Act does not permit corporations other than insurance companies to make deductions of the kind here under consideration, "reserve funds" may not reasonably be deemed to include values that do not directly pertain to insurance. In life insurance the reserve means the amount, accumulated by the company out of premium payments, which is attributable to and represents the value of the life insurance elements of the policy contracts. The premiums include enough, over and above what is needed to maintain proper insurance reserves, to provide for the discharge of coupon liability according to the terms of the policy. The coupon values are the equivalent of cash and may be used to pay premiums on the face amount of the policy, to procure additional insurance, to lessen the number of annual premiums, or otherwise to obtain insurance protection. The amounts so applied cease to exist as coupon liabilities and automatically become a part of the life insurance reserves. These differ essentially from coupon liability. Life insurance matures only upon the death of the insured and the life reserve is based upon that contingency, whereas liability on the matured coupons depends upon no contingency. It follows that the insurance reserves alone constitute the base on which the

> deduction is to be computed. Reserves against matured coupons are excluded. [Citing cases.]

Under the tests thus prescribed by this Court,[2] it is clear that the survivorship fund and the "additional liability on survivorship investment policies" involved in the case at bar are not entitled to be used as a basis for the deduction specified in the Revenue Act. It cannot be said that either fund "is attributable to and represents the value of the life insurance elements of the policy contracts". Each is attributable to the part of the premiums specially set aside to cover the tontine plan (R. 19). Here "the premiums include enough, over and above what is needed to maintain proper insurance reserves, to provide for" the tontine plan; and it is this very excess which constitutes the funds now in issue.

The lower court erroneously supposed that the *Inter-Mountain Insurance Co.* case decided that the test of whether a reserve fund could be used as the basis of a deduction was whether the liabilities to be met from that fund are or are not contingent. This is an obvious error, for the *Inter-Mountain Insurance Co.* case decided that the test was

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[2] Cf. *McCoach* v. *Insurance Co. of North America*, 244 U. S. 585; *Maryland Casualty Co.* v. *United States*, 251 U. S. 342; *United States* v. *Boston Insurance Co.*, 269 U. S. 197; *New York Life Insurance Co.* v. *Edwards*, 271 U. S. 109, 119, which hold that the term "reserve funds", as used in the Revenue Acts, has a technical meaning and does not include all reserves maintained pursuant to the requirements of state law or designated as such by state officials.

whether the fund is or is not designed to meet *life insurance* liabilities. The opinion of this Court emphasizes that *life insurance* reserves alone constitute the base on which the deduction is to be computed. A fund which is to meet a liability that matures only upon the survivorship of the insured is not a life insurance reserve, even though the participant in the tontine plan may elect to use his part of the fund to buy life insurance.

2. The decision of the lower court is in conflict not merely with an applicable decision of this Court, but also with two decisions of the Court of Claims. In *Minnesota Mutual Life Ins. Co.* v. *United States,* 66 C. Cls. 481, cert. den., 279 U. S. 856, it was held that reserves for deferred dividends, provisionally ascertained and held awaiting apportionment, on the company's outstanding deferred policies, and payable at the end of the tontine period to the then surviving members of the class of policyholders entitled thereto, did not constitute "reserve funds required by law" on which a tax deduction could be based. And *Continental Assur. Co.* v. *United States,* 8 F. Supp. 474 (C. Cls.)[3] held that a tax deduction could not be calculated upon the basis of reserves to meet liabilities to holders of matured, unsurrendered and unpaid coupons.

This conflict should be resolved not alone because of the importance of the issue, but also be-

[3] This case has been cited with apparent approval by this Court in *Helvering* v. *Inter-Mountain Life Ins. Co.*, 294 U. S. 686, at 690.

cause there are now pending in the lower courts and before the Board of Tax Appeals a number of cases in which the same problem is presented.

Wherefore, it is respectfully submitted that this petition should be granted.

STANLEY REED,
Solicitor General.

APRIL 1936.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791, 842:

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(a) *General rule.*—In the case of a life insurance company the term "net income" means the gross income less—

* * * * *

(2) RESERVE FUNDS.—An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subsection, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, * * *.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 971. *Tax-exempt interest and reserve funds.*—Under paragraphs (1) and (2) of section 203 (a), life insurance companies are entitled to deduct from gross income:

(1) Interest which is exempted in the case of other taxpayers by section 22 (b) (4) and articles 84–88; and

(2) Four per cent of the mean of the reserve funds held at the beginning and end of the taxable year, without any abatement on account of tax-exempt interest. (See decision of United States Supreme Court in the case of *National Life Insurance Co.* v. *United States* (277 U. S., 508).) The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State insurance

departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance.

In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserves thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. Reserves maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance, and unpaid brokerage will not be considered. A company is permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual statement. Generally speaking, the following will be considered reserves as contemplated by the law: Items 7–11 of the liability page of the annual statement for life insurance companies, and items 16–19 and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business. If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner

to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held. *Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered.* [Italics supplied.]

Laws of Illinois (Cahill's Illinois Revised Statutes, 1929, c. 73, par. 331, Sec. 10, p. 1542):

* * * * *

The Department of Trade and Commerce shall annually make valuations of all outstanding policies, additions thereto, unpaid dividends and all other obligations of every life insurance corporation doing business in this State. All valuations made by it or by its authority shall be made upon the *net premium* basis. The legal minimum standard for valuation of contracts issued before the first day of January, 1908, shall be the Actuaries' or Combined Experience Table of Mortality with interest at 4 per centum per annum and for valuation of contracts issued on or after said date shall be the *American Experience Table of Mortality with interest at 3½ per centum per annum.* [Italics supplied.]

* * * * *

Laws of Illinois (Cahill's Illinois Revised Statutes, 1929, c. 73, par. 375, Sec. 1 (5–c), p. 1549):

* * * that if any company shall issue any nonparticipating policy under the terms of which any stipulated part of premiums received is to be placed in a separate fund for subsequent apportionment, such com-

pany shall furnish the Department of Trade and Commerce each year * * * a statement showing any and all amounts provisionally set apart, ascertained or calculated or held awaiting apportionment upon such policies according to classes, at the beginning of said year, the additions made to the said fund during the year with the source from which such additions arose, the deductions made from the said fund (if permitted by the contract) during the year with the reasons therefor and the amount of said fund at the end of the year; *which shall be carried as a distinct and separate reserve liability of the company* for the benefit of the classes of policies from the premium payments on which the sum was accumulated. *No part of said fund prior to the time of distribution stipulated in the contract, shall be considered in determining the loan and cash and other surrender values provided for by this Act*. * * * [Italics supplied.]

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In the Supreme Court of the United States

OCTOBER TERM, 1936

No. 27

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

ILLINOIS LIFE INSURANCE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 21–26) is reported in 30 B. T. A. 1160. The opinion of the Circuit Court of Appeals (R. 31–36) is reported in 80 F. (2d) 280.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered November 26, 1935 (R. 37). Petition for rehearing was filed December 16, 1935 (R. 37), which was denied January 9, 1936 (R. 37). The petition for a writ of certiorari was filed April 7, 1936, and the writ was granted May 18, 1936 (R. 38). The jurisdiction of this Court rests on Sec-

tion 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether amounts held by respondent, a life insurance company, at the beginning and end of the calendar year 1929, to meet its liabilities to the holders of its then outstanding survivorship investment policies of life insurance on account of so-called "survivorship investment funds" and "additional liability on survivorship investment policies contingent on payment of deferred and uncollected premiums" constituted "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved will be found in the Appendix, *infra*, pp. 34–36.

STATEMENT

The facts in the case were stipulated (R. 9) as shown in the transcript of proceedings (R. 9–11). They may be summarized as follows:

Respondent is an Illinois corporation engaged in the business of writing and issuing policies of life insurance on the lives of individuals, with its home office in Chicago, Illinois (R. 9–10).

During and prior to the calendar year 1929 respondent issued so-called survivorship investment policies of life insurance (R. 10). A specimen copy designated "20 Payment Life-Survivorship Investment Policy Premium payable for 20

years -Non-Participating'' is set forth in the record as "Joint Exhibit A" (R. 11–20).

Said policies contain the following provision (R. 15):

SURVIVORSHIP INVESTMENT FUND

> The company guarantees that it will set aside, from each full year's premium paid to the Company after the first and to and including the twentieth, on account of this policy, the amount set forth as the Annual Contribution at the bottom of the Table of Payments on the fourth page hereof. The amounts so set aside shall be placed in a fund to be known as "The Survivorship Investment Fund", applicable to policies on the Survivorship Investment Plan issued in the same calendar year as this policy. The Company agrees that no deductions shall be made from said fund for any purpose whatsoever but that all contributions to said fund shall be accumulated at the rate of three and one-half per cent per annum, compound interest from the dates of the respective payments. The Company further agrees to apportion to this policy, as a Survivorship Investment, provided the Insured hereunder shall survive to the twentieth anniversary of the date hereof and that all premiums hereon have been paid, and not otherwise, a sum bearing the same proportion to the total amount of said fund as the total contributions thereto from premiums paid on this policy bear to the aggregate total contributions thereto from premiums paid

on all policies in the Survivorship Investment Class issued in the same calendar year as this policy and that are in force at the end of twenty years from their respective dates of issue, and on which all premiums have been duly paid. For the purpose of this provision a premium waived under Disability Provisions shall be held and construed as a premium paid.

The Company will furnish the Insured hereunder, upon his written request after this policy shall have been in force more than three years, a statement of the amount of this policy's proportionate share of the Survivorship Investment Fund then accumulated and held awaiting apportionment, without deduction, at the expiration of the Survivorship Investment Period.

and further contain the following (R. 16):

OPTIONAL SETTLEMENTS AT THE END OF TWENTY YEARS

A. The Insured may continue this policy as a Fully Paid-up policy, no further payment of premiums being required, and receive in addition thereto:

1. A cash payment of the Survivorship Investment hereto apportioned; or

2. A Fully Paid-up Non-Participating Life Policy, subject to satisfactory evidence of insurability, for such amount as will be purchased by the Survivorship Investment hereto apportioned, at the Company's then published single premium rate applicable at the then attained age of the insured; or

B. The Insured may surrender this policy and receive:

3. A cash payment of the Entire Cash Value, namely: the Guaranteed Cash Surrender Value of $6,100.00, and in addition thereto the Survivorship Investment hereto apportioned.

NOTE.—At the expiration of the Survivorship Investment Period, a statement will be rendered the Insured, setting forth the values of the above settlements. If the Insured fails to exercise his option to elect one of the aforesaid settlements, and to notify the Company thereof in writing at its Head Office within three months from the end of the Survivorship Investment Period, it is agreed that Settlement No. 1 shall automatically apply.

The specimen policy calls for the payment of an annual premium of $379.90, out of which there is set aside each year (from the second to the twentieth years) the sum of $64.60 in the "survivorship investment fund." (R. 20.)

Respondent's liabilities pursuant to the agreements contained in and peculiar to said survivorship investment policies as at December 31, 1928, and as at December 31, 1929, were as follows (R. 10):

	December 31, 1928	December 31, 1929
Survivorship investment funds	$3,249,580.06	$3,342,162.91
Additional liability on S. I. policies contingent on payment of deferred and uncollected premiums	48,707.53	47,334.82
Total	3,298,287.59	3,389,497.73

Respondent in its 1929 income tax return claimed and took as a deduction from gross income four per cent of the mean of said amounts of $3,298,-287.59 and $3,389,497.73, namely $133,755.71, on the ground that said amounts constituted "reserve funds required by law" within the meaning of the Revenue Act of 1928.

The Commissioner by an amendment to his answer before the Board (R. 8) assigned as error his failure to disallow the deduction claimed and thereupon asserted a deficiency on account thereof.

The Board of Tax Appeals, four members dissenting, held that said amounts of $3,298,287.59 and $3,389,497.73 held by respondent at the beginning and end of the calendar year 1929, respectively, constituted "reserve funds required by law" within the meaning of the Revenue Act of 1928 (R. 23–25) and allowed the claimed deduction. The Circuit Court of Appeals denied the Commissioner's petition for review.

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that a fixed liability, which might in the future be converted into life insurance at the option of a policyholder but which had not been so converted during the tax year, is one against which a technical insurance reserve such as is contemplated by Section 203 (a) (2) of the Revenue Act of 1928, may be set up and maintained.

2. In holding that the Survivorship Investment Fund with accumulations thereon held at the be-

ginning and end of the calendar year 1929 constituted "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.

3. In holding that respondent's liability on account of survivorship investment funds and additional liability on account of survivorship investment policies contingent on payment of deferred and uncollected premiums, against which respondent held so-called reserves at the beginning and end of the calendar year 1929, constitute "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928.

4. In holding that the legal reserves required to be maintained by respondent during the year 1929 under the laws of the State of Illinois included the amounts set aside by respondent in its survivorship investment fund, with accumulations thereon, and respondent's liabilities on survivorship investment policies contingent on the payment of deferred and uncollected premiums.

5. In affirming the decision of the Board of Tax Appeals and denying the Commissioner's petition for review.

SUMMARY OF ARGUMENT

The term "reserve" or "reserve funds required by law" has a special, technical, and peculiar meaning in the law of insurance. This has been established by the decisions of this Court in *McCoach* v. *Insurance Co. of N. Amer.*, 244 U. S. 585; *Maryland Casualty Co.* v. *United States*, 251 U. S. 342;

United States v. *Boston Insurance Co.*, 269 U. S. 197; *New York Life Ins. Co.* v. *Edwards*, 271 U. S. 109, and by the recent decision of this Court in *Helvering* v. *Inter-Mountain Insurance Co.*, 294 U. S. 686.

As applied to life insurance these terms mean, as is shown by the last of the above cases, a sum of money *actuarially* determined upon the basis of a selected table of mortality plus an assumed rate of interest in accordance with state law—in the case at bar upon the basis of the American Experience Table of Mortality with interest at 3½ per centum per annum under the laws of the State of Illinois—which is held against *life risks* on policies in force and unmatured. The amounts here in controversy were neither actuarially determined nor were they held against life risks. They were investment funds bearing a fixed rate of interest payable to the survivors. The liability of the company could be determined at any time without reference to any mortality tables. It was a fixed and definite liability on the part of the company. So far as the individual policyholder was concerned, the persons to whom the fund would be paid were undetermined and the amount which each beneficiary would receive was undetermined. But it was the policyholder and not the company who took the risk of receiving more or less, dependent upon the number of deaths. The amount which the company would have to pay was fixed and did not change with the number of deaths.

Therefore, these reserves constituted *solvency* reserves, which the respondent, under the laws of the State of Illinois, was required to carry as a liability distinct and separate from its life insurance reserve. No part of these amounts had been used to pay premiums or to purchase life insurance. During the year 1929 no part could have been so used. Upon the maturity of the policy at the end of twenty years a surviving policyholder could use his distributive share for any purpose, including, of course, the purchase of insurance from this or any other company, subject to satisfactory evidence of insurability. The option given in the policy to purchase insurance is not in fact an option, but only a suggestion. Life insurance reserves are those held to meet life insurance in force, not funds which may or may not be used to purchase life insurance in the future.

The decisions of the Board of Tax Appeals and the Circuit Court of Appeals are based upon misconceptions of the nature and character of the legal reserve of a life insurance company and its relation to the amounts here in issue.

ARGUMENT

The instant case again presents for the consideration of this Court the following question: What constitutes, within the meaning of the Federal statutes, a "reserve" or "reserve funds required by law" in the case of a life insurance company?

The policy contracts with which we are here concerned contain two distinct features: (1) a 20-payment *life insurance* contract against which the *net premium* or *legal reserve* must be held (this reserve deduction has already been allowed and is not here in dispute), and (2) a survivorship investment non-life insurance contract against which only so-called *solvency* reserves must be maintained.

The stipulated facts in the case show (R. 10) that at December 31, 1928, and December 31, 1929, respondent held $3,298,287.59 and $3,389,497.73, respectively, to meet its liabilities pursuant to the agreements, referred to in (2) above, contained in and peculiar to certain so-called survivorship investment policies of life insurance then outstanding. Four per cent of the mean of these amounts held, respectively, at the beginning and end of the calendar year 1929, or $133,755.71, respondent claimed as a deduction from gross income in making its 1929 income tax return on the ground that said amounts constituted "reserve funds required by law" within the meaning of Section 203 (a) (2) of the Revenue Act of 1928, *infra*. Respondent's contention, as above indicated, was sustained by the Board of Tax Appeals and by the Circuit Court of Appeals.

We contend that the amounts so held by respondent at the beginning and end, respectively, of the calendar year 1929, pursuant to the agreements contained in its outstanding survivorship investment

policies, were fixed liabilities of the company and not "reserve funds required by law" within the meaning of either the Revenue Act of 1928 or the laws of the State of Illinois.

I

THE TERM "RESERVE" OR "RESERVE FUNDS REQUIRED BY LAW" HAS A SPECIAL AND TECHNICAL MEANING IN THE BUSINESS OF INSURANCE AND IN THE FEDERAL STATUTES; IT REFERS TO A SUM, ACTUARIALLY COMPUTED ON THE BASIS OF MORTALITY TABLES, PLUS AN ASSUMED RATE OF INTEREST, WHICH WILL BE SUFFICIENT TO PAY LIFE INSURANCE RISKS WHEN THEY BECOME DUE

In *Helvering* v. *Inter-Mountain Insurance Co., supra,* this Court considered the meaning of the term "reserve" or "reserve funds required by law", within the meaning of Section 245 (a) (2) of the Revenue Act of 1921, reenacted as Section 203 (a) (2) of the 1928 Act here in issue. The company had contended that matured, unsurrendered, and unpaid coupons attached to so-called coupon policies of life insurance, which had become unconditionally due and payable on demand to their respective holders, constituted "reserve funds required by law." The amounts represented by these coupons when they became due had been left with the Company to accumulate at compound interest at the rate of 3½ percent per annum. A fund was thus created which the insured at his option might apply to the payment of premiums or withdraw in cash. Certain other options were available to the insured, none of which had been, or could have been, exercised during the taxable year.

One of these was the option to surrender his policy at its maturity in twenty years, together with all coupons attached thereto at date of issue, and to receive a paid-up policy for the original face amount plus an amount then purchasable with the coupon fund due him. This Court in disposing of the case said (p. 690):

> The word "reserve" has many meanings. * * * In life insurance the reserve means the amount, accumulated by the company out of premium payments, which is attributable to and represents the value of the *life insurance elements* of the policy contracts. The premiums include enough, over and above what is needed to maintain proper insurance reserves, to provide for the discharge of coupon liability according to the terms of the policy. The coupon values are the equivalent of cash and may be used to pay premiums on the face amount of the policy, to procure additional insurance, to lessen the number of annual premiums, or otherwise to obtain insurance protection. The amounts so applied cease to exist as coupon liabilities and automatically become a part of the life insurance reserves. These differ essentially from coupon liability. Life insurance matures only upon the death of the insured and the life reserve is based upon *that* contingency, whereas liability on the matured coupons depends upon no contingency. *It follows that the insurance reserves alone constitute the base on which the deduction is to be com-*

> *puted.* Reserves against matured coupons are excluded. *McCoach* v. *Insurance Co. of N. A.*, 244 U. S. 585, 589. *United States* v. *Boston Insurance Co.*, 269 U. S. 197, 202. *New York Life Ins. Co.* v. *Edwards*, 271 U. S. 109, 119. *Duffy* v. *Mutual Benefit Ins. Co.*, 272 U. S. 613, 618–619. *Continental Assurance Co.* v. *United States*, 8 F. Supp. 474. (Italics supplied.)

This case follows the decisions in *McCoach* v. *Insurance Co. of N. Amer.*, 244 U. S. 585; *United States* v. *Boston Insurance Co.*, 269 U. S. 197; and *New York Life Ins. Co.* v. *Edwards*, 271 U. S. 109, which have consistently upheld the principle that the term "reserve" or "reserve funds required by law" has a special and technical meaning in the business of insurance. These cases have made it clear that in any type of insurance the fund must be one held against an insurance risk. The term does not include liabilities which can be computed by the simple addition of interest to payments made. If the liability can be so computed, the contingency that the claim might not have to be paid at all, as in the case of litigated claims, or the uncertainty as to who the beneficiary might be, as in the case of unreported death losses, does not make the funds held against those claims a reserve. With respect to life insurance, the term means a fund actuarially computed upon the basis of a selected table of mortality, plus an assumed rate of interest, held to meet *life risks* on policies of *life insurance* in force and unmatured.

This conception of the term "reserve" has been departed from only in a single dictum in *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, 350, in which the Court included as a part of the "reserve", "claims accrued, but contingent and indefinite as to the amount or time of payment." That dictum, however, was expressly overruled in *United States* v. *Boston Insurance Co.,* 269 U. S. 197, where the Court said (p. 203):

> Upon a re-examination of the record it becomes plain that we misapprehended the opinion and ruling of the lower court; also that the reason advanced to support our conclusion is insufficient * * *. The finding that the Insurance Department of Pennsylvania, pursuant to statute, had at all times since and including 1909 required claimant to keep on hand, as a condition of doing business in the State, "assets as reserves sufficient to cover outstanding losses", without more, was not sufficient to justify the deduction of the reserve as one required by law to be maintained, within the meaning of the Act of Congress. This had been announced by *McCoach* v. *Insurance Co.*

All of the cases last cited involved Revenue Acts[1] enacted prior to the Revenue Act of 1921. While Congress adopted a new plan for the taxation of

[1] Act of August 5, 1909, c. 6, 36 Stat. 11, 112, Sec. 38; Act of October 3, 1913, c. 16, 38 Stat. 114, 166, 172, Sec. II G. (b); Revenue Act of 1916, c. 463, 39 Stat. 756, 767–768, Sec. 12 (a) Second; Revenue Act of 1918, c. 18, 40 Stat. 1057, 1077–1079, Sec. 234 (a) (10).

life insurance companies in the latter Act, there is no indication of a purpose to give the term "reserve funds required by law" a new meaning. Under prior Acts the gross income of life insurance companies included their premium receipts, and they were permitted to deduct the amounts paid on policies (except as dividends), and the net addition required by law to be added to their legal reserves. The inclusion of premium receipts with corresponding deductions was found to be unsatisfactory, and in the Revenue Act of 1921, with the approval of at least most of the life insurance companies, Congress substituted a new basis for computing the tax. See dissenting opinion of Mr. Justice Brandeis in *Nat'l Life Ins. Co.* v. *United States,* 277 U. S. 508, 522–523. It was provided that the gross income should consist of investment income, that is, income from "interests, dividends, and rents" (Sec. 244 (a), Revenue Act of 1921), and in order to ascertain the net taxable income, nine classes of deductions were allowed, one of which is that here in issue.

It has been shown that this term "reserve" or "reserve funds required by law" has a special and technical meaning in the business of life insurance. It will be helpful to consider briefly how such "reserve" is calculated; among those at all familiar with the business there is no dispute as to how this is done. *Jefferson* v. *New York Life Insurance Co.,* 151 Ky. 609, 616.

In Yale Readings on Insurance—Life, pp. 193, 194, it is said:

> The laws of the several states prescribe the maximum rate of interest that may be assumed and the *mortality table* that shall be used, in computing the reserve or net value of a company's policies. This requirement is termed the *legal standard of valuation.* The net value computed by the *legal standard* is termed the *legal net value or legal reserve.* (Italics supplied.)

It has been said that the "net premium coming due is the foundation of the reserve." *Fink* v. *Northwestern Mut. Life Ins. Co.,* 267 Fed. 968, 973 (C. C. A. 7th).

In level premium life insurance, here in question, the "net premium" is calculated, first, by adopting an accepted table of mortality, showing the death rate for each age of life; and, second, by adopting an assumed rate of interest such as the company may safely expect to realize on its invested assets for the duration of all its policies. With these two factors, it is calculated just what sum each insured must pay yearly in advance so as to put the company in funds with which to pay all outstanding policies as they become claims, provided deaths occur exactly in accordance with the table of mortality, and also provided the rate of interest on the company's invested funds is exactly the same as the rate assumed in calculating its premiums. The sum ascertained in this way is

called the net or mathematical premium and is commonly referred to as the net premium reserve. *New York Life Ins. Co.* v. *Edwards,* 8 F. (2d) 851, 852 (C. C. A. 2d); *State ex rel. Supreme Lodge K. P.* v. *Vandiver, Supt. Ins.,* 213 Mo. 187. Under former Revenue Acts the net addition to this premium reserve was one of the deductions allowed from gross income.

Since under the Revenue Act of 1921, and subsequent Revenue Acts,[2] underwriting income (premium receipts) is not included in the gross income of life insurance companies, the deduction of the mortality content in the "net or mathematical premium" could no longer be permitted; accordingly, the deduction of the net addition to the reserve funds required by law was eliminated. There still remained for consideration, however, the interest content in the "net or mathematical premium", since it was clear that a portion of the interest, dividends, and rents received by a life insurance company must be used each year in maintaining the legal reserve, that is, in adding to it on the basis of a certain interest rate, varying from 3% to 4%, according to the requirements of the statutes of the several States. Since gross income included all interest, dividends, and rents received, Congress allowed the deduction of that portion thereof in-

[2] Section 244 (a) of the Revenue Acts of 1921, c. 136, 42 Stat. 227; 1924, c. 234, 43 Stat. 253; 1926, c. 27, 44 Stat. 9; and Section 202 (a) of the Revenue Act of 1928, c. 852, 45 Stat. 791.

cluded in the gross income which was required to mature the policy as a life risk, namely, the interest element. Accordingly Congress provided for the deduction of 4 per centum of the mean of the reserve (the highest percent required to be credited thereto by any of the state laws), and based the deduction upon the mean of the reserves held at the beginning and end of the taxable year.

The deduction allowed by Section 245 (a) (2) of the Revenue Acts of 1921, 1924, and 1926 and by Section 203 (a) (2) of the Revenue Act of 1928 is perfectly consistent with that permitted by prior Acts. Both were deductions of the portion of gross income defined by the Act which was required to be held in the insurance "reserve." Since in the later Acts premiums were not considered gross income, the only part of the taxable income which went into the reserve was the interest element. Therefore, only the interest required to be added to the reserve was allowed as a deduction. The principle, however, is the same and no different meaning is to be attributed to the term "reserve" under the later Acts. See *Massachusetts Mut. Life Ins. Co.* v. *United States,* 56 F. (2d) 897 (C. Cls.); *Standard Life Insurance Co. of America* v. *Commissioner,* 13 B. T. A. 13, 27.

In view of the foregoing, we submit that the term "reserve funds required by law" as it is used in the Revenue Act of 1928 does not embrace everything required as a reserve by state statute or state official, that its special and technical meaning for

life insurance purposes contemplates a fund actuarially computed, set aside from premiums, and built up with accretions from interest to meet life risks upon life policies in force and unmatured. Other reserves, although required by state law, are mere solvency reserves and not the special and technical reserve peculiar to life insurance contemplated by the Act.

II

THE FOUR PER CENT OF THE MEAN OF THE SO-CALLED RESERVES IN QUESTION IN THIS CASE IS NOT AN ALLOWABLE DEDUCTION UNDER SECTION 203 (a) (2) OF THE REVENUE ACT OF 1928

The statutes of Illinois make the same distinction between life insurance reserves and solvency reserves which has been made by this Court in the foregoing decisions. This appears from the provision of Cahill's Illinois Revised Statutes, 1929, c. 73, par. 331, Sec. 10, p. 1542, in force during the year 1929, covering the annual valuation of policies of life insurance companies and the basis upon which the reserves of a life insurance company under the laws of that State is calculated, that section, so far as deemed material here, providing:

> The Department of Trade and Commerce shall annually make valuations of all outstanding policies, additions thereto, unpaid dividends and all other obligations of every life insurance corporation doing business in

> this State. All valuations made by it or by its authority shall be made upon the *net premium* basis. The legal minimum standard for valuation of contracts issued before the first day of January 1908, shall be the Actuaries' or Combined Experience Table of Mortality with interest at 4 per centum per annum and for valuation of contracts issued on or after said date *shall be the American Experience Table of Mortality with interest at 3½ per centum per annum.* (Italics supplied.)

Thus under the laws of the State of Illinois all valuations of life insurance policies "shall be made upon the net premium basis" and the legal minimum standard of valuation after January 1, 1908, shall be "the American Experience Table of Mortality with interest at 3½ per centum per annum."

It is undisputed that the amounts held by respondent at the beginning and end of the calendar year 1929, respectively, in the Survivorship Investment Fund were required to be "carried as a distinct and separate reserve liability" under the provisions of Section 1 (5–c) of the Laws of Illinois, 1907, p. 367, as amended, and in force during the year 1929 (see Cahill, Illinois Revised Statutes, 1929, c. 73, par. 375, Section 1 (5–c), p. 1549), which, among other things, provides:

> * * * that if any company shall issue any nonparticipating policy under the terms of which any stipulated part of premiums received is to be placed in a separate fund

> for subsequent apportionment, such company shall furnish the Department of Trade and Commerce each year * * * a statement showing any and all amounts provisionally set apart, ascertained or calculated or held awaiting apportionment upon such policies according to classes, at the beginning of said year, the additions made to the said fund during the year with the source from which such additions arose, the deductions made from the said fund (if permitted by the contract) during the year with the reasons therefor and the amount of said fund at the end of the year; *which shall be carried as a distinct and separate reserve liability of the company* for the benefit of the classes of policies from the premium payments on which the sum was accumulated. *No part of said fund prior to the time of distribution stipulated in the contract, shall be considered in determining the loan and cash and other surrender values provided for by this Act.* * * * No such policy shall be issued which by its terms shall provide that more than twenty-five percent of the annual premium shall be placed in such fund, nor shall any such provision be made a part of a term insurance policy. (Italics supplied.)

Thus respondent was required to have on hand not only the legal reserve peculiar to life insurance contracts calculated upon the basis of "the American Experience Table of Mortality with interest at 3½ per centum per annum", but in addition "a

distinct and separate reserve liability" not computed on mortality tables.

The distinction made by the Illinois statutes between life insurance reserves and solvency reserves is further emphasized by the provision in the statutes that "No part of said fund prior to the time of distribution stipulated in the contract, shall be considered in determining the loan and cash and other surrender values provided for by this Act."

That the Survivorship Investment Fund here in issue did not represent life insurance in force will be shown by an examination of the "Optional Settlements at the End of Twenty Years" (R. 16).

Under these optional settlements the insured at the end of the 20 year tontine period, *if then living and in good standing,* was entitled to continue his policy as a "Fully Paid-up" policy without the payment of further premiums, and *in addition* to receive his share of the Survivorship Investment Fund, then apportioned to his policy, in cash. Receipt by him of this cash, however, had no effect on his policy of life insurance. That continued as a fully paid-up policy for its original face amount.

The insured, however, *subject to satisfactory evidence of insurability,* could use his cash payment to buy an additional "Fully Paid-up Non-Participating Life Policy" for such amount as might be purchased at the company's then published single premium rate applicable at the then attained age of the insured, obviously as any pros-

pective policyholder might do, if then insurable and at the same age, with an equal amount of cash. Or the insured might surrender his policy for its then cash surrender value of $6,100, since that sum was the legal reserve on a 20 Payment Life Non-Participating Policy for $10,000 issued at the age 35 (see R. 20—Table 1, Cash and loan values) and *in addition* receive in cash his share of the Survivorship Investment Fund then apportioned to his policy at the end of the tontine period.

If the insured, however, failed to exercise any of the options available to him within three months from the end of the survivorship investment period the contract provided that the amount apportioned to his policy should be paid in cash.

In view of these "Optional Settlements" provisions it is clear, we submit, that the amounts held by respondent in the Survivorship Investment Fund during the calendar year 1929 were not held against insurance in force and unmatured. This fund was to be apportioned only at the end of the tontine period of 20 years to the surviving members of the class then entitled thereto, when for the first time a surviving policyholder might purchase additional fully paid up insurance in the event of which the amount paid became an insurance premium and thereupon contributed its share to the company's legal reserve. *Helvering* v. *Inter-Mountain Insurance Co., supra.*

Clearly the annual contribution to the Survivorship Investment Fund of $64.60 called for by the

policy contract (R. 20) was an arbitrary amount and not actuarially computed. It did not represent a life insurance premium but a Survivorship *Investment* as provided by the contract which the Company was required to hold for distribution to those policyholders who survived to the end of the tontine period. On December 31, 1928, and December 31, 1929, respectively, the Survivorship Investment Fund under the specific terms of the policy contract constituted not a life insurance reserve but a fixed liability of the Company which, if the Company was to remain solvent, it was required under the laws of Illinois to carry as "a distinct and separate reserve liability." This fund was in no wise based upon the contingency of death. Death, on the contrary, terminated the right of the policyholder, his estate or his beneficiary to share in the distribution of the fund. In life insurance, however, death matures the policy as a claim on the legal reserve held for all of the Company's policyholders as a *group*.

In *Minnesota Mutual Life Ins. Co.* v. *United States,* 66 C. Cls. 481, certiorari denied, 279 U. S. 856, the same controversy in the case at bar was involved except that the amounts there in issue were the dividends of a mutual life insurance company set aside in a fund provisionally ascertained and held by the company and, as here, awaiting apportionment to the surviving members of the class of policyholders entitled thereto at the end of the

tontine period. Section 3497, General Statutes of Minnesota, 1913, provided that the amount of such apportioned surplus, plus the actual interest earnings and accretions of such fund should be carried—

> as a distinct and separate liability to such class of policies on and for which the same was accumulated, and no company or any of its officers shall be permitted to use any part of such apportioned surplus fund for any purpose whatsoever other than for the express purpose for which the same was accumulated.

In that case it was contended, as it was contended here, that the so-called reserve required to be so held constituted "reserve funds required by law" within the meaning of the Federal statutes, notwithstanding that the distribution there to be made, as here, was *contingent* upon survivorship. The contention was denied because, as here, the fund held was not held on account of *life insurance in force*. The so-called reserve in that case and, we most respectfully submit, the so-called reserve in this case were "solvency" reserves required by state law to keep the Company in a sound financial condition, and not the deductible "reserve" contemplated by the Revenue Acts. *McCoach* v. *Insurance Co. of N. Amer.*, 244 U. S. 585.

The total liability of the Company on the "Survivorship Investment Fund" in the present case is in no way dependent on the mortality of the

group. In an insurance risk the company must write enough policies so that the laws of probability will make it reasonably safe. In the present type of policy, where the company pays out only what it gets plus interest, the company is as safe with one policy as with a hundred thousand. It takes exactly the same risk as a savings bank, and no more. Therefore, the funds necessarily are required to be kept separate from the funds securing the life risks of a group.

In distinguishing this case from *Helvering* v. *Inter-Mountain Insurance Co., supra,* the court below said (R. 33):

> It is apparent from the language that the determining element [in the *Inter-Mountain* case] was the fact that the matured coupons no longer represented contingent liabilities.

The court went on to say that the survivorship feature created uncertainty (1) as to the beneficiary, and (2) as to the amount which any beneficiary would receive. These facts the court said "effectively distinguish matured liabilities upon coupons, noncontingent in character [as in the *Inter-Mountain* case], from the contingent liabilities protected by the survivorship investment fund." Clearly, the court in so holding misconstrued the decision in *Helvering* v. *Inter-Mountain Insurance Co.* The test laid down in that case is, as we have shown above, whether the fund (the

legal reserve) is held to meet *life insurance* risks; the test is not, as held by the court below, whether the fund is set aside to meet contingent liabilities. This appears clearly in the *Inter-Mountain* case, where this Court said (p. 690):

> Life insurance matures only upon the death of the insured *and the life reserve is based upon that contingency* * * *. (Emphasis supplied.)

Furthermore, even under the rule adopted by the court below, the respondent would not be entitled to the deduction. The amount for which the insurance company is liable under the survivorship investment feature of the policies here involved does not depend upon any contingency. That amount could be determined by a mathematical computation of the premiums paid, plus interest. From the point of view of the insured, the benefit was contingent but from the point of view of the Company the sum for which it would be liable to the group was certain. The bare possibility that none of the group might survive, while it might wipe out the liability entirely, does not make the amount of liability to that group uncertain. It has been squarely held that reserves for unreported death losses, which may never have to be paid, are not insurance reserves. *New York Life* v. *Edwards, supra.* The real distinguishing characteristic of an insurance reserve is the fact that it must be computed on the basis of the laws of probability

exemplified in the mortality tables. It is this that makes the amount of liability to the policyholders as a group uncertain and contingent on the number of deaths. Contingencies which affect the benefits to be received by the individual policyholder are immaterial.

The court below also stated (R. 35) that "life insurance today is not limited to policies for the payment of losses in case of death", giving as an example the fact that endowment insurance is payable not only on death, but upon surviving for a specified period. Therefore, the court thought that since the survivorship investment fund in the present case, which provided for the payment of the accumulated funds to the survivors, was attached to a policy providing for payment on death, it "was not essentially different from endowment insurance." Accordingly, the court considered that the survivorship investment feature of the policy in this case constituted life insurance.

It is not at all clear that the endowment feature of an endowment life insurance policy is life insurance, since that feature does not involve payment on the death of the insured. On the contrary, it is a payment only in the event he lives, and in computing the reserves on such policies, the part of the premium for pure endowment is separable from that part which pays for life insurance during the term of the endowment. However, it is sufficient to point out here that endowment policies are not

involved in the present case. Reserves for endowment policies must be actuarially computed. Such policies do not, as in this case, simply divide among the survivors whatever amounts are paid in plus interest. They are obligations for a specific sum. In order to determine the premium necessary to provide for that sum, it is necessary for the company to estimate the number who will not survive by using mortality tables, and to assume the risk that the survivors will be in excess of that number. In this case the amount of liability of the company can never exceed the amount paid in by the policyholders plus interest. The only risk taken is the *business* risk of not earning the interest agreed on. This risk is not in any way contingent upon either the death or the continued life of the policyholders. The policyholders are joint tenants in a fund which the company agrees to invest for them at a guaranteed rate, keeping the profits over and above that rate.

Furthermore, though the survivorship investment fund is attached to a twenty year payment life insurance policy, there is no logical relationship between the two. In an endowment policy, the life feature assures the payment of the face of the policy if the insured does not survive. The amount of the endowment determines the amount of the life insurance; the period before maturity of the endowment determines the length of the term

of the insurance. In the present policy the amount paid into the survivorship fund is arbitrarily fixed. The amount paid to any individual survivor is not fixed in advance, and has no logical connection with the amount of life insurance, other than the fact that the two are permitted by the law of Illinois to be incorporated in a single document.

The court below also referred to the policy in this case as an example of a semi-tontine policy (R. 35), and stated that "contracts of endowment or *tontine* character * * * are properly insurance contracts." It is submitted that a semi-tontine policy is in the nature of a deferred dividend policy, and that reserves for deferred dividends are not insurance reserves. However, no semi-tontine policy is involved in this case. The arbitrarily fixed premiums paid to the survivorship investment fund are not dividends in any sense.

The use of the word Tontine in connection with life insurance, which originated from a speculative scheme devised by Leonardo Tonti, has been briefly described by Willey in his work on Life Insurance as follows (pp. 28–29):

> This peculiar word is derived from the name of an Italian, Leonardo Tonti, who first suggested the form of investment, or speculation, which now goes under the name of a Tontine. It is a fund subscribed with the understanding that it will accumulate for a time, and thereafter be divided amongst the surviving contributors. Ton-

tines are now practically unknown, and have been little used since the beginning of the 19th century. The word is frequently used in life insurance to distinguish a certain form of surplus, spoken of as a—

Tontine Dividend.—This form of dividend was popular so long as it was the practice to forfeit entirely the policy value in event of the insured discontinuing payment of premiums. When the practice of guaranteeing liberal surrender values arose, the advantages in the Tontine Dividend form of distribution to a great extent disappeared. Policies which were entitled to a Tontine Dividend were placed in a class by themselves, and the premiums were accumulated for the specific benefit of the members of that class. The expenses of management and claims by death applicable to the class were charged out, and at the end of the Tontine period the aggregate policy values were also deducted from the fund. The remainder was the surplus which fell to be distributed amongst the policyholders then existing. Usually also the right was given at that time to withdraw the entire policy value. At the termination of a Tontine period, therefore, the entire fund contributed by the members of any specific class was understood to be closed out.

Semi-Tontine Dividends.—This form was introduced after it became customary to pay surrender values on the discontinuance of policies after being three years in force. It

is practically the equivalent of a deferred dividend policy, and the latter name is now generally preferred.

The resemblance between the survivorship feature of this fund and the original tontine investment speculation is obvious. An amount arbitrarily determined is allowed to accumulate at interest and is divided among the survivors. The speculative nature of the plan may be what influenced the legislature of Illinois to limit the contributions to 25% of the premiums of the policy to which it is attached. There certainly is no logical limit to the amount which might be paid in and distributed in this way. However, resemblance to Tonti's obsolete device, or its subsequent modification, has no relevance to the definition of life insurance reserves under the Revenue Act of 1928.

CONCLUSION

Tested by the principles announced by this Court in *Helvering* v. *Inter-Mountain Insurance Co., supra,* and in the prior decisions of this Court to which reference has been made, the so-called reserves held by respondent and in issue in this case did not constitute "reserve funds required by law" within the meaning of either Section 203 (a) (2) of the Revenue Act of 1928 or the laws of the State of Illinois.

To allow insurance companies to deduct from gross income a percentage of so-called solvency reserves securing pure investment contracts is to

give them an unwarranted advantage over other investment concerns which are compelled to carry reserves. The practical justification for the technical definition of life insurance reserves adopted by the Court is that it avoids giving an unfair advantage or incentive to life insurance companies to compete in the investment field. That consideration was emphasized by this Court in *Helvering* v. *Inter-Mountain Insurance Co., supra,* as follows (p. 690):

> As the Act does not permit corporations other than insurance companies to make deductions of the kind here under consideration, "reserve funds" may not reasonably be deemed to include values that do not directly pertain to insurance.

It is respectfully submitted that the decision of the court below is erroneous and should be reversed.

STANLEY REED,
Solicitor General,
ROBERT H. JACKSON,
Assistant Attorney General.
THURMAN ARNOLD,
SEWALL KEY,
NORMAN D. KELLER,
EDWARD H. HORTON,
Special Assistants to the Attorney General.

SEPTEMBER 1936.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 203. NET INCOME OF LIFE INSURANCE COMPANIES.

(a) *General rule.*—In the case of a life insurance company the term "net income" means the gross income less—

* * * * *

(2) *Reserve funds.*—An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subsection, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, * * *.

Treasury Regulations 74, promulgated under the Revenue Act of 1928:

ART. 971. *Tax-exempt interest and reserve funds.*—Under paragraphs (1) and (2) of section 203 (a), life insurance companies are entitled to deduct from gross income:

(1) Interest which is exempted in the case of other taxpayers by section 22 (b) (4) and articles 84–88; and

(2) Four per cent of the mean of the reserve funds held at the beginning and end of the taxable year, without any abatement on account of tax-exempt interest. (See decision of United States Supreme Court in the case of *National Life Insurance Co.* v. *United States* (277 U. S. 508).) The reserve deduction is based upon the reserves required by express statutory provisions or by the rules and regulations of the State in-

surance departments when promulgated in the exercise of a power conferred by statute; but such reserves do not include assets required to be held for the ordinary running expenses of the business nor do they include the reserve or net value of risks reinsured in other solvent companies to the extent of the reinsurance.

In the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation, it is required that reserves thereon be based upon recognized tables of experience covering disability benefits of the kind contained in policies issued by this particular class of companies. Reserves maintained to provide for the ordinary running expenses of a business, definite in amount, and which must be currently paid by every company from its income if its business is to continue, such as taxes, salaries, reinsurance, and unpaid brokerage will not be considered. A company is permitted to make use of the highest aggregate reserve called for by any State in which it transacts business, but the reserve must have been actually held as shown by the annual statement. Generally speaking, the following will be considered reserves as contemplated by the law: Items 7–11 of the liability page of the annual statement for life insurance companies, and items 16–19 and 26 of the liability page of the annual statement for miscellaneous stock companies, if a life insurance company is also transacting other kinds of insurance business. If other reserves are claimed, sufficient information must be filed with the return to enable the Commissioner

to determine the validity of the claim. Reference should be made to the item in which the reserve appears in the annual statement and to the State statute or insurance department ruling requiring that such reserves be held. *Only reserves which are so required, which are peculiar to insurance companies, and which are dependent upon interest earnings for their maintenance will be considered.* (Italics supplied.)

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APR 27 19
CHARLES ELMORE

No. [redacted] 27

IN THE

Supreme Court of the United States

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

ILLINOIS LIFE INSURANCE COMPANY,
Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION TO THE PETITION FOR CERTIORARI.

ROY O. WEST,
PERCY B. ECKHART,
WILLIAM M. KLEIN,
LEWIS C. JESSEPH,
SAMUEL B. KRAUS,
Counsel for Respondent.

THE GUNTHORP-WARREN PRINTING COMPANY, 210 WEST JACKSON, CHICAGO

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IN THE

Supreme Court of the United States

No. 903.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

ILLINOIS LIFE INSURANCE COMPANY,

Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION TO THE PETITION FOR CERTIORARI.

OPINION OF THE COURT BELOW.

The decision of the Circuit Court of Appeals for the Seventh Circuit, rendered November 26, 1935, rehearing denied January 9, 1936, is reported in 80 Fed. (2d), page 280, and affirms the opinion of the United States Board of Tax Appeals, reported in 30 B. T. A. 1160.

STATEMENT OF THE CASE.

The statement of the case contained in the petition filed herein is substantially sufficient for the consideration of the questions raised upon such petition excepting for one ap-

parently inadvertent inaccuracy, which we deem it desirable to correct.

In describing the first option available to holders of survivorship investment policies at the expiration of twenty years, it is said at the top of page 4 of the petition that in the event of the insured continuing his policy as a paid-up policy at the end of twenty years, he shall receive "a cash payment of the survivorship investment *then* apportioned to his policy," the word "then" being italicized. The policy (Joint Exhibit A), however, does not contain the word "then," and the apportionment is directed to be made pursuant to the formula contained in the policy when issued.

SUMMARY.

I.

THE SURVIVORSHIP INVESTMENT FUND IS A RESERVE REQUIRED BY THE LAWS OF ILLINOIS AND, AS SUCH, FORMS THE BASIS OF A DEDUCTION FROM GROSS INCOME UNDER THE REVENUE ACT OF 1928.

1907 Illinois Session Laws 367 (Cahill's Illinois Revised Statutes for 1929, also 1935, Chap. 73, Par. 375, Secs. 1 and 5-c).

Revenue Act of 1928, Sec. 203.

II.

THE SURVIVORSHIP INVESTMENT INSURANCE ISSUED BY THE RESPONDENT IS A MODIFIED FORM OF TONTINE LIFE INSURANCE, AN OLD ESTABLISHED AND WELL RECOGNIZED FORM OF LIFE INSURANCE.

Holden v. *Stratton,* 198 U. S. 202.

Hiscock v. *Mertens,* 205 U. S. 202.

New York Life Ins. Co. v. *Edwards,* 271 U. S. 109.

Penn Mutual Co. v. *Lederer,* 252 U. S. 523.

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Gourley v. *Northwestern Nat. Life Ins. Co.,* 94 Okla. 46; 220 Pac. 645.

37 Corpus Juris, 363.

1 Cooley's Briefs on Insurance (2nd Ed.) p. 162.

Briggs v. *McCullough,* 36 Calif. 542.

Endowment etc. Ass'n. v. *State,* 35 Kan. 253.

(a) The liability of an insurance company under tontine policies is contingent and the legal reserves required under such policies are life insurance reserves within the meaning of Section 203 of the Revenue Act of 1928.

Avery v. *Equitable Life Assur. Soc.*, 117 N. Y. 451, 23 N. E. 3.

1 Cooley's Briefs on Insurance (2nd Ed.) p. 172.

III.

NEITHER BY THE REVENUE ACT NOR BY THE DECISION OF THIS COURT IN HELVERING VS. INTER-MOUNTAIN LIFE INSURANCE CO. IS THE PHRASE "RESERVE FUNDS REQUIRED BY LAW" SO LIMITED AS TO EXCLUDE INSURANCE RESERVES REQUIRED AND SET UP TO COVER INSURANCE LIABILITIES WHICH SHALL ACCRUE UPON CONTINGENCIES OTHER THAN THE CONTINGENCY OF DEATH, SUCH AS THE LIABILITY FOR ENDOWMENT AND TONTINE PAYMENTS, BOTH OF WHICH ARE DEPENDENT UPON SURVIVORSHIP OF A FIXED DATE.

See Argument.

ARGUMENT.

I.

THE SURVIVORSHIP INVESTMENT FUND IS A RESERVE REQUIRED BY THE LAWS OF ILLINOIS AND, AS SUCH, FORMS THE BASIS OF A DEDUCTION FROM GROSS INCOME UNDER THE REVENUE ACT OF 1928.

The fundamental questions in the case at bar are whether the reserves involved are required by the law of Illinois, and whether they are insurance reserves as distinguished from solvency reserves. The pertinent Illinois statute in force in the taxable year 1929 is found in the 1907 Illinois Session Laws, page 367 (Cahill's Ill. Rev. Stats., 1929, also 1935, Chap. 73, Par. 375). The applicable provisions are:

> "SEC. 1. That from and after January 1, 1908, no policy of life insurance shall be issued or delivered in this State or be issued by a life insurance company organized under the laws of this State, unless the same shall provide the following:
>
> * * * * * *
>
> (5-c) * * * if any company shall issue any non-participating policy under the terms of which any stipulated part of premiums received is to be placed in a separate fund for subsequent apportionment, such company shall furnish the Department of Trade and Commerce each year a statement showing the number and amount of all such policies in force at the beginning of the year for which the statement is made; of all such policies issued and revived or terminated during the said year with the mode of termination; and the number and amount of all such policies in force at the end of said year. Also a statement showing any and all amounts provisionally set apart, ascertained or calculated or held awaiting apportionment upon such policies according to classes, at the beginning of said year, the additions made to the said fund during the year with the source from which such additions arose, the

deductions made from the said fund (if permitted by the contract) during the year with the reasons therefor and the amount of said fund at the end of the year; *which shall be carried as a distinct and separate reserve liability of the company for the benefit of the classes of policies from the premium payments on which the sum was accumulated.* No part of said fund prior to the time of distribution stipulated in the contract, shall be considered in determining the loan and cash and other surrender values provided for by this Act * * *." [Italics supplied.]

It is not disputed that Paragraph (5-c) of Section 1 applies to precisely the type of policy introduced as Joint Exhibit "A", and that the portions of the premiums allocated to said reserve fund are expressly required to

"be carried as a distinct and separate reserve liability of the company for the benefit of the classes of policies from the premium payments on which the sum was accumulated."

Section 203 (a) (2) of the Revenue Act of 1928 describing the deductible reserves reads:

"An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subsection, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only."

Petitioner's contention is that although the survivorship investment fund is a reserve required by Illinois law, it is not an *insurance* reserve and therefore furnishes no basis for a deduction.

II.

THE SURVIVORSHIP INVESTMENT INSURANCE ISSUED BY THE RESPONDENT IS A MODIFIED FORM OF TONTINE LIFE INSURANCE, AN OLD ESTABLISHED AND WELL RECOGNIZED FORM OF LIFE INSURANCE; THE LIABILITY OF THE INSURANCE COMPANY THEREUNDER IS CONTINGENT; AND THE LEGAL RESERVES REQUIRED UNDER SUCH POLICIES ARE LIFE INSURANCE RESERVES WITHIN THE MEANING OF SECTION 203 OF THE REVENUE ACT OF 1928.

Although the petitioner goes only so far as to deny the deductibility of the reserve in question for the assigned reason that it is not a "*life insurance*" reserve, the argument must be followed through to its ultimate implication that the reserve is not a life insurance reserve because the survivorship investment benefit is not life insurance—or, better still, is not insurance—for if the tontine benefit is not *life* insurance, what kind of insurance is it?

The most common kinds of life insurance are ordinary life insurance and endowment insurance, in the latter of which the full amount of the insurance proceeds is payable to the insured in the event of his surviving a fixed period of years. There are other kinds of insurance, however, and among them are the tontine and semi-tontine methods of insurance.

An excellent and brief definition, description, and history of tontine insurance are found in 37 Corpus Juris, page 363, where it is said:

> "Tontine insurance is a form of life insurance by which the policyholder agrees, in common with the other policyholders under the same plan, that no dividend, return premium, or surrender value shall be received for a term of years called the 'tontine period,' the entire surplus from all sources being allowed to accumulate to the end of that period, and then divided among all who have maintained their insurance in force, the beneficiary of an insured who dies within

> the tontine period being entitled only to the insurance provided for by the policy, and not to participation in the profits. This system of insurance is a modification of the original tontine principle, which took its name from Lorenzo Tonti, an Italian of the seventeenth century, who first conceived the idea and put it in practice, and the general idea of which was that money or property was loaned, owned, or invested for the benefit of a number of persons, who at first received its income, the share of a deceased member increasing the sum divisible among the survivors, and the last survivor taking the whole income or principal as the case may be."

Another description of the tontine policy is contained in *Gourley* v. *Northwestern Nat. Life Ins. Co.*, 94 Oklahoma 46, 220 Pac. 645, 646. At page 47 it is said:

> "The distinctive features of a tontine policy are: That the dividends of a certain group of policies shall be collected and placed into a particular fund during a given number of years, and distributed to the policy holders, at the expiration of the time named. The years during which the fund is accumulated is known as the tontine period. Those who die or lapse their policies lose the benefit of the accumulated dividends, which go to the benefit of those who completed the tontine period. *Uhlman* v. *N. Y. Life Ins. Co.*, 109 N. Y. 421, 4 Amer. St. Rep. 482; *Pierce* v. *Equitable Life Ins. Society* (Mass.) 12 N. E. 858."

The modern tontine (or semi-tontine) plan, which involves a combination of regular life insurance as to the return of a specific sum payable upon death, and another sum payable to the insured upon his survivorship of the tontine period, is essentially the same as endowment insurance. In only two respects do they differ: First, under the endowment plan the entire insurance proceeds are payable to the insured upon his surviving a specified date, whereas under the tontine plan only the investment reserve is payable to the insured upon his surviving the specified date, and the remainder of the insurance proceeds is payable to the bene-

ficiary upon the death of the insured. The second difference is that under the endowment plan the amount payable is definitely fixed in advance, whereas under the tontine plan the amount payable is not fixed until the expiration of the period, because it consists of the entire amount of the tontine reserve divided by the number of then surviving members of that tontine class.

In 1 Cooley's Briefs on Insurance (2nd Ed.), 162, endowment policies and tontine policies are grouped together in a single section.

The essential similarity of semi-tontine insurance and ordinary insurance of any other type is manifest upon considering these types from another viewpoint. Under an ordinary life insurance policy a specified amount is payable upon the death of the insured to designated beneficiaries. Under the tontine plan, upon the same event (death of the insured) an amount measured by the contributions of the insured plus accumulations thereon, is added to a fund held for a differently described group of beneficiaries, *i. e.*, for the members of the tontine class who survive the stipulated period. This viewpoint has given rise to the question whether tontine insurance is really insurance or a gambling contract because of an alleged lack of insurable interest of the various class members in one another. The overwhelming weight of authority in this court, Illinois courts, and the courts of the several states is that tontine or semi-tontine policies are insurance contracts and not gambling contracts or some other species of undertaking. Semi-tontine policies like those in the case at bar were involved, and their validity was recognized by this court, in the four cases discussed below.

Holden v. *Stratton*, 198 U. S. 202, was a bankruptcy proceeding involving the question of whether, under Section

70 of the Bankruptcy Act of 1898, the trustee in bankruptcy took title to certain life insurance policies on the life of the bankrupt. One of the policies was on the semi-tontine plan and was described in the statement of facts at page 203 as follows: "The policy for $5,000 was on what was termed the semi-tontine plan. An annual premium of $233.80 was required to be paid for ten years from the date of the previous policy, which had been surrendered, that is, until May 21, 1900, and therefore at the date when the bankrupts contracted the debts set forth in their schedules and at the date of the adjudications in bankruptcy, this period had expired and no further payment of premiums was necessary. Upon the death of the insured the amount of the policy was to be paid to the wife as the beneficiary, or, in the contingency of her prior decease, to the executors, administrators or assigns of the insured. It was provided, however, that upon the completion of the tontine dividend period of twenty years—on May 21, 1910—if the insured was then alive, he or his assigns, if creditors, might surrender the policy and receive its full cash value, or a non-participating policy, payable to the original beneficiary, or if she was not alive, to the executors, administrators or assigns of the insured, or the option was given to keep the policy in force and to withdraw the surplus to the credit of the policy in cash, or use the same to purchase additional insurance."

The bankrupt contended that Section 70 of the Bankruptcy Act did not apply because under the applicable laws of the State of Washington, where he lived, life insurance proceeds were exempt from all liability for debt, and Section 6 of the Bankruptcy Act gave effect to the exemption laws of the several states. The argument made to this court was that the tontine fund was not properly "life insurance" and hence such proceeds were not exempt under the Washington statute, which argument is summarized by

this court at page 209 of its opinion as follows: "The arguments supporting this contention are somewhat involved, but are all embraced in the following propositions: First, life insurance, it is said, in its strictest and technical sense, relates only to a fund realizable by death, and therefore the words 'all life insurance,' in the Washington statute, must be given that restricted meaning, hence the statute is inapplicable to one of the policies which partakes of the nature of an endowment," etc.

Such argument was disposed of at page 210 of this court's opinion where it is said:

> "The error in the argument is manifest. It is not to be doubted that the broad terms of the statute, as ordinarily understood, embraced both of the policies, and it would not be construction but legislation to restrict the meaning of the statute in accord with narrower legislation in other States, because in the judgment of a court it might be deemed equitable to do so."

That the proceeds of the tontine element of an insurance policy is "life insurance" and is not some other species of property is also clearly recognized in another bankruptcy case, *Hiscock* v. *Mertens*, 205 U. S. 202, 213, which also involved conflicting claims of the bankrupt and the trustee in bankruptcy, the latter claiming that the bankrupt should be required to assign the insurance policies to him because of the absence of any express provision for a cash surrender value, whereas the bankrupt contended that the trustee was entitled to no more than the actual cash surrender value under the existing practices of the company, which amount he had tendered to the trustee. The policies in question were described in the master's report incorporated at pages 206-207 of this court's opinion as follows: "None of these express any agreement or provision whereby upon default the company shall pay a 'cash surrender value' to any person. By their terms the assured is excluded from any participation in dividends until the completion

of the tontine period, at which time all surplus and profits derived from such policies are to be divided among the persistent policies of that class then in force. At the expiration of the tontine period the persistent policy holder is given certain options, among them to withdraw in cash the policy's entire share of the assets, that is, the accumulated reserve, the amount of which is stated in each policy, and, in addition, the accumulated surplus apportioned to the policy."

The trustee was anxious to procure the policies because of the augmented value attributable to the tontine element which was not considered in determining the cash surrender value. At page 213 this court said:

> "Manifestly a policy cannot be declared in or out of the law according to its age, nor can anything be deduced from the investment features of tontine policies. Such policies were decided to be covered by the law in *Holden* v. *Stratton*. Whether the law should have included them is not our concern. Whatever may be said against it, it has seemed best to the legislature to encourage the extra endeavor and sacrifice which such policies may represent."

It was similarly argued in the case of *Briggs* v. *McCullough*, 36 Cal. 542, that the endowment proceeds of a ten year endowment policy were not insurance but simply the proceeds of "a covenant by the company, that in consideration of a certain sum deposited by McCullough, the company will pay him at the expiration of ten years, or sooner, if he dies, a certain other stipulated sum." It was also contended that such proceeds were consequently not within the protection of the California Statute which specifically exempted insurance proceeds from attachment. The court said at page 550:

> "The term 'life insurance' is not alone applicable to an insurance for the full term of one's life. On the contrary, it may be for a term of years, or until the assured shall arrive at a certain age. * * * It is an un-

> dertaking to pay the stipulated sum if he shall die within a specified term, which is of the very essence of life insurance. The fact that the company is to pay the agreed sum at the expiration of ten years, even though McCullough shall not have died in the meantime, does not divest it of its character of life insurance."

The principal difference between the endowment plan which is universally upheld and the semi-tontine or survivorship investment plan which petitioner now questions is that in the former a fixed sum is payable to the insured in the event of survivorship, whereas, under the latter, the endowment cannot be computed until the expiration of the tontine period, and it may be lost in the event of the death of the insured during such period. The mere fact that the payment of the tontine investment is contingent upon survivorship instead of death does not derogate from its character as insurance, for the same is equally true of the usual endowment which likewise is payable in the event of survivorship.

Semi-tontine policies were involved in an income tax case before this court, *New York Life Ins. Co.* v. *Edwards*, 271 U. S. 109. In that case the insurance company contended, on the supposed authority of *Penn Mutual* v. *Lederer, Collector*, 252 U. S. 523, that the "overpayments" on mutual, level premium, deferred dividend policies should be deducted in determining the premium receipts which formed an element of the gross income in computing the insurance company's net taxable income. As appears at the end of page 115 in the *New York Life Insurance* case, the "deferred dividend" or "distribution" policies provided—"That no dividend or surplus shall be allowed or paid upon this policy, unless the insured shall survive until completion of its distribution period, and unless this policy shall then be in force. That surplus or profits derived from such policies on the distribution policy plan as shall not be in force at the date of the completion of their respective dis-

tribution periods, shall be apportioned among such policies as shall complete the distribution periods." Clearly, such deferred dividend policies were semi-tontine policies precisely like the survivorship investment policies now under consideration. In the prior case of *Penn Mutual Co.* v. *Lederer, Collector,* (252 U. S. 523) this court had held that where mutual life insurance "overpayments" had been paid back or credited to the individual policyholders or treated as an abatement of premium of such policyholders, the amount thereof should not be included in the company's income. In the *New York Life Insurance Company* case, 271 U. S. 109, however, this court at page 116 held otherwise with respect to the deferred dividend policies, for the sole reason that, under the policy provisions above quoted, no part of the overpayment was repaid or credited to the policyholder but that

> "the aggregate of all such payments was held for distribution among policyholders alive at the end of the period. The receipts for the year were not really diminished."

In the *Penn Mutual* case, 252 U. S. 523, this court, at the bottom of page 532, couples " 'Deferred Dividend' and other semi-tontine policies." In neither of the above two cases does this court intimate that a semi-tontine policy does not provide for *insurance* or for *life* insurance.

The validity of the tontine type of contract was directly attacked and sustained in Illinois in the case of *Rothschild* v. *New York Life Insurance Co.,* 97 Ill. App. 547. In that case the holder of several policies on the tontine plan (described as "the accumulation plan"—page 549), under which the reserve was distributable upon twenty-years' survivorship, filed a bill at the end of five years to set aside the policies, alleging that he had been misled as to their nature and had just ascertained "that said policies are cunningly devised gaming contracts, etc." (p. 551.) By the

bill, complainant also sought to recover the amount of his contribution to the tontine or accumulation fund. Complainant also relied upon the statutory provision which "requires distribution of surplus at least once in every five years" (p. 555), and also "that a discrimination as to the distribution of the surplus is made in favor of those who survive April 4, 1915, the accumulation period, and against those who may die before that time; that the former are to be regarded as one class and the latter another." The Illinois Appellate Court held the policies not subject to any of the foregoing objections. At page 556 the court says:

> "There is no discrimination against any member. Each member, in so far as surplus is concerned, makes the same contract. It is the same in principal as if each member contracted for a sum certain in the event of his death, plus a certain percentage of such sum, in case he should survive April 4, 1915.
>
> Lastly, it is contended that the effect of the provision as to the accumulation period, April 4, 1915, and the provision that no dividend shall be apportioned or paid before the end of that period, is that each policy holder bets with all the others that he will survive April 4, 1915, and therefore the provisions are in violation of section 131 of chapter 38, Hurd's Rev. Stat. 1899, in respect to gaming contracts. We can not concur in the view that the contracts are wagers or bets within the meaning of section 131. Section 134 of the same chapter is as follows:
>
> 'Nothing contained in sections 131 and 132 above, shall be (so) construed as to prohibit or in any way affect any insurance made in good faith for the security or indemnity of the party insured and which is not otherwise prohibited by law, nor to any contract of bottomry or *respondentia.*'
>
> The averments of the bill do not sustain the view that appellant's contracts of insurance were not made in good faith for his security or indemnity; and, as we have already held, they were not prohibited by law."

Inferentially, the validity of tontine policies was sustained by the Illinois Supreme Court in

Townsend v. *Equitable Life Society*, 263 Ill. 432, in which the court held that a bill for an accounting by a surviving member of the tontine class was not vulnerable to demurrer where it was alleged that the distribution made by the company was not equitable and in accordance with the plan.

At the present time, few, if any, strictly tontine policies are issued because of the non-forfeiture laws of most states forbidding the forfeiture of life insurance policies after two or three years' premiums have been paid. This has brought about a modification of the tontine plan which is now usually coupled with and embodied in an ordinary life insurance policy, the principal proceeds of which are payable upon death. This plan of insurance is known under divers names, such as semi-tontine, survivorship investment policies, investment reserve policies, accumulation reserve policies, etc. The theory underlying the modern tontine policy is set forth in the definition of the word tontine in the Century Dictionary, as follows:

> "This modification of ordinary life insurance has been adopted as optional with the insured for the purpose of countervailing the tendency to burden long lived and persistent policy holders with a large amount of premiums in comparison with those whose lives fall in shortly after obtaining insurance. The effect is to reduce the sum payable on deaths after but few years payment of premiums and to increase the sum payable on deaths occurring after a given number of years."

The tontine element of such semi-tontine life insurance contracts is a feature designed to make the life insurance investment more attractive to the person of exceptionally long lived stock whose actual expectancy can reasonably be presumed to exceed the ordinary expectancy of his age, upon which the premiums are based, and to make the possible investment gain to him upon survivorship commensurate with the excessive cost to him because of the computation of the premium upon such ordinary shorter expectancy.

III.

NEITHER BY THE REVENUE ACT NOR BY THE DECISION OF THIS COURT IN HELVERING VS. INTER-MOUNTAIN LIFE INSURANCE CO. IS THE PHRASE "RESERVE FUNDS REQUIRED BY LAW" SO LIMITED AS TO EXCLUDE INSURANCE RESERVES REQUIRED AND SET UP TO COVER INSURANCE LIABILITIES WHICH SHALL ACCRUE UPON CONTINGENCIES OTHER THAN THE CONTINGENCY OF DEATH, SUCH AS THE LIABILITY FOR ENDOWMENT AND TONTINE PAYMENTS, BOTH OF WHICH ARE DEPENDENT UPON SURVIVORSHIP OF A FIXED DATE.

At the outset it should be observed that Section 203 (a) (2) of the Revenue Act of 1928 (See page 6, *ante*) expressly provides for the deduction of 4 per cent of the mean of reserves other than life insurance reserves—health and accident insurance combined in one policy with a certain type of life insurance.

The Petitioner asks this court to review the decision of the lower court in this case because of an alleged conflict of that decision with a recent decision of this court and two prior decisions of the United States Court of Claims. One of the latter cases is *Continental Assurance Co.* v. *United States,* 8 Fed. Suppl. 474, in which the facts were substantially the same as were involved in the decision of this court in *Helvering* v. *Inter-Mountain Life Insurance Co.* 294 U. S. 686. The facts in those two cases were so widely different from those in the case at bar that there could be no conflict in the decisions. Both cases involved the deductibility of a percentage of reserves required to be set aside to cover the liability upon *matured coupons* which, upon their maturity, had ceased to be contingent liabilities and had become debts immediately payable to the policy holders, or subject to application as the policy holders' funds in the manner specified in their policies. Because the facts of the cases are identical, we shall confine ourselves to comments upon the *Inter-Mountain Life Insurance Company* case, all

of which comments are, however, equally applicable to the *Continental Assurance Co.* case. In the *Inter-Mountain Life Insurance Company* case, the pertinent facts were stated by Mr. Justice Butler at page 688 as follows:

> "The record contains a specimen policy for $10,000 applicable to age 35 issued in consideration of 20 annual premiums of $420.90. Attached are 19 coupons maturing serially on anniversary dates of the policy beginning with the first and ending with the nineteenth. Each coupon is a promise that at its maturity the company will pay the amount specified to the owner of the policy.
>
> The policy states: The company will credit insured the face amount of any matured coupon as it becomes due and pay compound interest thereon, thereby creating a fund to the credit of the insured which may be applied to the payment of premiums or at any time withdrawn in cash; and if not so applied or withdrawn prior to his death, it will pay the coupon values with interest to date of death to the beneficiary in addition to the face amount of the policy."

It will at once be perceived that "each coupon is a promise that at *its* maturity the company will pay the amount specified." This single sentence illustrates the wide divergence of the two cases. In a case involving reserves against matured and unpaid coupons there is a fixed and definite liability *immediately payable* upon the maturity of each coupon. When that day arrives all element of contingency vanishes and the insurance company immediately becomes a debtor in the amount specified. It is true that the insured has certain options even under the coupon plan, but those options only relate to the application which shall be made by the insurance company of the moneys in its hands belonging to the insured. The gist of the decision in the *Inter-Mountain Life Insurance Company* case is that the only reserves properly deductible are those providing for *contingent* liabilities, whereas the liability of the insurance company upon *matured coupons* is not contingent, or as this

court said: "Liability on the matured coupons depends upon no contingency." This is obviously true, and it is equally obvious that the liability of the respondent upon its survivorship investment policies is contingent. The two plans are wholly different. The matured coupons involved in the *Inter-Mountain Insurance Company* case represented actual *immediate* liabilities of the insurance company and debts actually then due and owing from the insurance company to the coupon-holders. The liability of the respondent under the policies here involved is, however, a *future* and *contingent* liability which may or may not at some future date ripen into an indebtedness. We do not have in mind so much the possibility of the policyholder failing to persist in the payment of premiums as we do the contingency of his failure to survive the tontine period.

In 1 Cooley's Briefs on Insurance (2nd Ed., 1927), it is said at page 172:

> "Until the expiration of the tontine period, the liability of the company is contingent (*Avery* v. *Equitable Life Assur. Soc.*, 117 N. Y. 459, 23 N. E. 3). On the expiration of the period, the relation of debtor and creditor arises."

The several cases cited by that author amply support the text. The same author continues at page 172:

> "So, where the insured died a short time before the expiration of the period, his beneficiary was entitled to no share in the tontine fund."

That is, of course, quite different from the liability of the insurance company in the *Inter-Mountain Insurance Company* case, for in that case there was a debtor-creditor relationship immediately upon the maturity of the several coupons and had insured died before payment of any such matured coupon the company would have remained *pro tanto* liable to his estate.

The distinction we have pointed out between the rights of the tontine policyholders in the case at bar and the rights

of the holders of matured coupons in the *Inter-Mountain Life Insurance Company* case is borne out by the language of this court in *Duffy* v. *Mutual Benefit Co.*, 272 U. S. 613. That was a proceeding involving the determination of the insurance company's excess profits tax, the specific question being whether the legal reserves set up by the company constituted "invested capital." The insurance company contended that they did not constitute capital, but represented an existing liability. The Supreme Court held otherwise, however, saying at page 618:

> "These assets, thus constituted, have never represented indebtedness any more than the capital of a stock corporation subscribed by its stockholders represents indebtedness. Until the maturity of a policy, the policyholder is simply a member of the corporation, with no present enforceable right against the assets. Upon the maturity of the policy he becomes a creditor with an enforceable right. Then for the first time there is an indebtedness. See *Mayer* v. *Attorney General*, 32 N. J. Eq. 815, 820-822."

Similarly in the cases we are now considering. In the *Inter-Mountain Life Insurance Company* case the coupons involved had matured so that the policyholders had become creditors and there was an existing indebtedness. In the case at bar, however, the policies had not matured, and prior to the expiration of the tontine period the policyholders had no present enforceable rights against the assets of the company. Whether or not they ever would obtain such rights in the future is involved in the contingency of survivoriship.

It thus appears that the *Inter-Mountain Life Insurance Company* case is in no respect parallel with the case at bar and is valueless as authority under the facts involved in the present case. Inasmuch as petitioner's entire case is founded upon the supposed authority of the *Inter-Mountain Life Insurance Company* decision, petitioner's case is not supported by any authority. On the other hand, the facts

involved take the present case outside the express limitations announced in the rule in the *Inter-Mountain Life Insurance Company* case wherein this court predicated its decision on the fact that the case involved the deductibility of reserves for *matured coupons*. These the court held to be an immediate fixed indebtedness free from any contingency, whereas in the present case there can be no actual liability of the company to pay until the expiration of the tontine period, and even then such liability as to each member of the class is contingent upon survivorship.

As to the other Court of Claims case cited by Petitioner, *Minnesota Mutual Life Insurance Co.* v. *United States*, 66 Ct. Cl. 481, decided in December, 1928, it is sufficient to say that thereafter, on April 1, 1935, this court in *Helvering* v. *Inter-Mountain Life Insurance Co.* 294 U. S. 686, finally and definitely settled the question of the deductibility of insurance reserves. The gist and limits of the doctrine announced by this court are contained in this brief excerpt from the opinion at page 690:

> "The coupon values are the equivalent of cash * * *. Liability on the matured coupons depends upon no contingency."

It is evident to us that this court did not intend to go any farther than indicated above, and did intend to deny deductibility only with respect to reserves for insurance liabilities of a wholly noncontingent character. Inasmuch as no conflict of decisions has developed since this court so positively announced the rule, no ground for review exists.

CONCLUSION.

It is respectfully submitted that the Circuit Court of Appeals for the Seventh Circuit correctly decided the question presented in the Petition for Certiorari, in conformity with the applicable and controlling decisions of this court and the weight of authority generally, and that the said court correctly arrived at each of the following conclusions: That the survivorship investment fund policies employed by the Respondent cover semi-tontine insurance; that semi-tontine insurance is life insurance and not a gambling contract; that the Respondent's liability respecting such investment funds is contingent; that the Illinois statute requires the maintenance of the reserves set up by the Respondent on the said policies; that such reserves are, therefore, life insurance reserves required under the laws of the state and are deductible under Section 203 (a) (2) of the Revenue Act of 1928. We, therefore, respectfully urge that the Petition for Certiorari should be denied.

Counsel for Respondent,

ROY O. WEST,
PERCY B. ECKHART,
WILLIAM M. KLEIN,
LEWIS C. JESSEPH,
SAMUEL B. KRAUS.

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No. 27

IN THE

Supreme Court of the United States

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

ILLINOIS LIFE INSURANCE COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR THE RESPONDENT.

ROY O. WEST,
PERCY B. ECKHART,
WILLIAM M. KLEIN,
SAMUEL B. KRAUS,
Attorneys for Respondent.

THE GUNTHORP-WARREN PRINTING COMPANY, 310 WEST JACKSON, CHICAGO

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IN THE

Supreme Court of the United States

No. 27.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

ILLINOIS LIFE INSURANCE COMPANY,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR THE RESPONDENT.

OPINION OF THE COURT BELOW.

The decision of the Circuit Court of Appeals for the Seventh Circuit, rendered November 26, 1935, rehearing denied January 9, 1936, is reported in 80 Fed. (2d), page 280, and affirms the opinion of the United States Board of Tax Appeals, reported in 30 B. T. A. 1160.

STATEMENT OF THE CASE.

The statement of the case contained in the brief filed herein on behalf of the Petitioner is substantially correct. Attention is called to the further facts that by the Survivorship Investment Policy used by the Respondent (set forth at pages 3, *et sequitur* of the brief for the Petitioner), the

Respondent company, guarantees to set aside, in each year after the first, in "the Survivorship Investment Fund" the amount of the "Annual Contribution" set forth at page 4 of the policy; that no deductions shall be made from the said fund for any purpose whatsoever; that all contributions to said fund shall be accumulated at the rate of 3½ per cent per annum compound interest from the dates of the respective payments; and that at the end of twenty (20) years the company shall apportion to the surviving persistent holders of such respective policies a sum bearing the same proportion to the total amount of said fund as the total contributions thereto from premiums on the respective policies bear to the aggregate total contributions thereto from premiums paid on all policies in the Survivorship Investment Class issued in the same year as any policy under consideration. The company is further required, after any such policy shall have been in force more than three (3) years, to furnish the insured, upon written request, a statement of the amount of such policy's proportionate share of the Survivorship Investment Fund then accumulated, etc. (R. 20; Printed Record 16.)

SUMMARY.

I.

THE SURVIVORSHIP INVESTMENT FUND IS A RESERVE REQUIRED BY THE LAWS OF ILLINOIS AND, AS SUCH, FORMS THE BASIS OF A DEDUCTION FROM GROSS INCOME UNDER THE REVENUE ACT OF 1928.

Illinois Legislative Act of May 20, 1907, as amended;
1907 Ill. Session Laws, 367;
1917 Ill. Session Laws, 548;
1921 Ill. Session Laws, 483;
Cahill's Revised Stats. for 1929, Chap. 73, Par. 375, Secs. 1 and 5-c;
U. S. Revenue Act of 1928, Sec. 203.

II.

THE SURVIVORSHIP INVESTMENT INSURANCE ISSUED BY THE RESPONDENT IS A MODIFIED FORM OF TONTINE LIFE INSURANCE, AN OLD ESTABLISHED AND WELL RECOGNIZED FORM OF LIFE INSURANCE.

Connecticut etc. Insur. Co. v. *Schaefer*, 94 U. S. 457.
Holden v. *Stratton*, 198 U. S. 202.
Hiscock v. *Mertens*, 205 U. S. 202.
New York Life Ins. Co. v. *Edwards*, 271 U. S. 109.
Penn Mutual Co. v. *Lederer*, 252 U. S. 523.
Rothschild v. *New York Life Ins. Co.*, 97 Ill. App. 547.
Townsend v. *Equitable Life*, 263 Ill. 432.
Gourley v. *Northwestern Nat. Life Ins. Co.*, 94 Okla. 46; 220 Pac. 645.
37 Corpus Juris, 363.

1 Cooley's Briefs on Insurance (2nd Ed.) p. 162, 170.

Briggs v. *McCullough*, 36 Calif. 542.

Endowment etc. Ass'n v. *State*, 35 Kan. 253.

(a) The liability of an insurance company under tontine policies is contingent and the legal reserves required under such policies are life insurance reserves within the meaning of Section 203 of the Revenue Act of 1928.

Avery v. *Equitable Life Assur. Soc.*, 117 N. Y, 451, 23 N. E. 3.

1 Cooley's Briefs on Insurance (2nd Ed.) p. 172.

III.

NEITHER BY THE REVENUE ACT NOR BY THE DECISION OF THIS COURT IN HELVERING VS. INTER-MOUNTAIN LIFE INSURANCE CO. IS THE PHRASE "RESERVE FUNDS REQUIRED BY LAW" SO LIMITED AS TO EXCLUDE INSURANCE RESERVES REQUIRED AND SET UP TO COVER INSURANCE LIABILITIES WHICH SHALL ACCRUE UPON CONTINGENCIES OTHER THAN THE CONTINGENCY OF DEATH, SUCH AS THE LIABILITY FOR ENDOWMENT AND TONTINE PAYMENTS, BOTH OF WHICH ARE DEPENDENT UPON SURVIVORSHIP OF A FIXED DATE AND PERSISTENCE IN PAYMENT OF PREMIUMS.

See Argument.

ARGUMENT.

I.

THE SURVIVORSHIP INVESTMENT FUND IS A RESERVE REQUIRED BY THE LAWS OF ILLINOIS AND, AS SUCH, FORMS THE BASIS OF A DEDUCTION FROM GROSS INCOME UNDER THE REVENUE ACT OF 1928.

The fundamental questions in the case at bar are whether the reserves involved are required by the law of Illinois, and whether they are insurance reserves as distinguished from solvency reserves. The pertinent Illinois statute in force in the taxable year 1929 is officially printed in the 1907 Illinois Session Laws, page 367 and the amendments bringing it to its present form are officially printed in 1917 Illinois Session Laws, 548, and 1921 Illinois Session Laws, 483 (Cahill's Ill. Rev. Stats., 1929, also 1935, Chap. 73, Par. 375). The applicable provisions are:

> "SEC. 1. That from and after January 1, 1908, no policy of life insurance shall be issued or delivered in this State or be issued by a life insurance company organized under the laws of this State, unless the same shall provide the following:
>
> * * * * *
>
> (5-c) * * * if any company shall issue any non-participating policy under the terms of which any stipulated part of premiums received is to be placed in a separate fund for subsequent apportionment, such company shall furnish the Department of Trade and Commerce each year a statement showing the number and amount of all such policies in force at the beginning of the year for which the statement is made; of all such policies issued and revived or terminated during the said year with the mode of termination; and the number and amount of all such policies in force at the end of said year. Also a statement showing any and all amounts provisionally set apart, ascertained or calculated or held awaiting apportionment upon

such policies according to classes, at the beginning of said year, the additions made to the said fund during the year with the source from which such additions arose, the deductions made from the said fund (if permitted by the contract) during the year with the reasons therefor and the amount of said fund at the end of the year; *which shall be carried as a distinct and separate reserve liability of the company for the benefit of the classes of policies from the premium payments on which the sum was accumulated.* No part of said fund prior to the time of distribution stipulated in the contract, shall be considered in determining the loan and cash and other surrender values provided for by this Act * * *." [Italics supplied.]

It is not disputed that Paragraph (5-c) of Section 1 applies to precisely the type of policy introduced as Joint Exhibit "A", and that the portions of the premiums allocated to said reserve fund are expressly required to

> "be carried as a distinct and separate reserve liability of the company for the benefit of the classes of policies from the premium payments on which the sum was accumulated."

Section 203 (a) (2) of the Revenue Act of 1928 describing the deductible reserves reads:

> "An amount equal to the excess, if any, over the deduction specified in paragraph (1) of this subsection, of 4 per centum of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only."

Petitioner's contention is that although the survivorship investment fund is a reserve required by Illinois law, it is not an *insurance* reserve and therefore furnishes no basis for a deduction.

II.

THE SURVIVORSHIP INVESTMENT INSURANCE ISSUED BY THE RESPONDENT IS A MODIFIED FORM OF TONTINE LIFE INSURANCE, AN OLD ESTABLISHED AND WELL RECOGNIZED FORM OF LIFE INSURANCE; THE LIABILITY OF THE INSURANCE COMPANY THEREUNDER IS CONTINGENT; AND THE LEGAL RESERVES REQUIRED UNDER SUCH POLICIES ARE LIFE INSURANCE RESERVES WITHIN THE MEANING OF SECTION 203 OF THE REVENUE ACT OF 1928.

Although the petitioner goes only so far as to deny the deductibility of the reserve in question for the assigned reason that it is not a "*life insurance*" reserve, the argument must be followed through to its ultimate implication that the reserve is not a life insurance reserve because the survivorship investment benefit is not life insurance—or, better still, is not insurance—for if the tontine benefit is not *life* insurance, what kind of insurance is it?

The most common kinds of life insurance are ordinary life insurance and endowment insurance, in the latter of which the full amount of the insurance proceeds is payable to the insured in the event of his surviving a fixed period of years. There are other kinds of insurance, however, and among them are the tontine and semi-tontine methods of insurance.

Tontine insurance is described in 37 Corpus Juris, page 363, as follows:

> "Tontine insurance is a form of life insurance by which the policyholder agrees, in common with the other policyholders under the same plan, that no dividend, return premium, or surrender value shall be received for a term of years called the 'tontine period,' the entire surplus from all sources being allowed to accumulate to the end of that period, and then divided among all who have maintained their insurance in force, the beneficiary of an insured who dies within the tontine period being entitled only to the insurance provided for by the policy, and not to participation in

> the profits. This system of insurance is a modification of the original tontine principle, which took its name from Lorenzo Tonti, an Italian of the seventeenth century, who first conceived the idea and put it in practice, and the general idea of which was that money or property was loaned, owned, or invested for the benefit of a number of persons, who at first received its income, the share of a deceased member increasing the sum divisible among the survivors, and the last survivor taking the whole income or principal as the case may be."

For a somewhat more elaborate description and history of tontine insurance, reference is made to the testimony of Mr. John A. McCall, quondam President of the New York Life Insurance Company at the hearings before the New York Insurance Investigating Committee, Volume 2, Page 1420, and the testimony of Mr. Emory McClintock, quondam Actuary of the Mutual Life Insurance Company of New York, at the said hearings, Volume 3, Page 2350.

In more recent times insurance companies have ceased writing tontine policies, but (excepting in States where any form of tontine policy was prohibited by statute) various types of modified tontine policies have been issued under different names, such as semi-tontine, free-tontine, deferred dividend, etc.

These various forms of policies involve a combination of regular life insurance as to the return of a specific sum payable upon death, and another sum payable to the insured upon his survivorship of the tontine period. They are essentially the same as endowment insurance. In only two material respects do they differ: First, under the endowment plan the entire insurance proceeds are payable to the insured upon his surviving a specified date, whereas under the semi-tontine plan only the investment reserve is payable to the insured upon his surviving the specified date, and the remainder of the insurance proceeds is payable to the beneficiary upon the death of the insured. The second

difference is that under the endowment plan the amount payable is definitely fixed in advance, whereas under the tontine plan the amount payable is not fixed until the expiration of the period, because it consists of the entire amount of the tontine reserve divided among the then surviving members of that tontine class in the proportions of their contributions.

In 1 Cooley's Briefs on Insurance (2nd Ed.), 162, endowment policies and tontine policies are grouped together in a single section and at page 170, the author says:

> "This tontine plan does not affect the instrument as a policy of insurance on life, but merely engrafts thereon an endowment or profit-sharing feature."

The essential similarity of semi-tontine insurance and ordinary insurance of any other type is manifest upon considering these types from another viewpoint. Under an ordinary life insurance policy a specified amount is payable upon the death of the insured to designated beneficiaries. Under the tontine plan, upon the same event (death of the insured) an amount measured by the contributions of the insured plus accumulations thereon, is added to a fund held for a differently described group of beneficiaries, *i. e.*, for the persistent members of the tontine class who survive the stipulated period. This viewpoint has given rise to the question whether tontine insurance is really insurance or a gambling contract because of an alleged lack of insurable interest of the various class members in one another. The overwhelming weight of authority in this court, Illinois courts, and the courts of the several states is that tontine or semi-tontine policies are insurance contracts and not gambling contracts or some other species of undertaking. Semi-tontine polices like those in the case at bar were considered and their validity and character as life insurance policies were recognized by this court, in the cases discussed below.

Connecticut Mutual Life Insurance Company v. *Schaefer*, 94 U. S. 457, decided October, 1876, was an action against an insurance company to recover the amount of the policy upon the death of the insured and was brought by the beneficiary who was the divorced wife of the insured, the divorce having been granted subsequent to the issuance of the policy. The company sought to defend upon the ground of the cessation of any insurable interest in the beneficiary. At page 460, this court, per Mr. Justice Bradley, said:

> "It is well settled that a man has an insurable interest in his own life, and in that of his wife and children; a woman in the life of her husband; and the creditor in the life of his debtor. Indeed, it may be said generally that any reasonable expectation of pecuniary benefit or advantage from the continued life of another creates an insurable interest in such life. And there is no doubt that a man may effect an insurance on his own life for the benefit of a relative or friend; or two or more persons, on their joint lives, for the benefit of the survivor or survivors. *The old tontines were based substantially on this principle, and their validity has never been called in question.*" (Italics supplied.)

This case is extremely interesting in view of the fact that *life insurance* taken out by an individual on his own life for the benefit of a person unrelated to him at the time the policy becomes payable was held valid upon the analogy of that situation to the case of "the old tontines", of which this court says: "their validity has never been called in question." In other words, this court regards tontine (or semi-tontine) insurance as insurance taken out by the insured upon his own life for the benefit of all those persons who are in the same tontine class. These are all persons in whose life the insured has an interest, for they are all contributors to the fund raised for the benefit of the persistent survivors of the class.

Holden v. *Stratton*, 198 U. S. 202, was a bankruptcy proceeding involving the question of whether, under Section

70 of the Bankruptcy Act of 1898, the trustee in bankruptcy took title to certain life insurance policies on the life of the bankrupt. One of the policies was on the semi-tontine plan and was described in the statement of facts at page 203 as follows: "The policy for $5,000 was on what was termed the semi-tontine plan. An annual premium of $233.80 was required to be paid for ten years from the date of the previous policy, which had been surrendered, that is, until May 21, 1900, and therefore at the date when the bankrupts contracted the debts set forth in their schedules and at the date of the adjudications in bankruptcy, this period had expired and no further payment of premiums was necessary. Upon the death of the insured the amount of the policy was to be paid to the wife as the beneficiary, or, in the contingency of her prior decease, to the executors, administrators or assigns of the insured. It was provided, however, that upon the completion of the tontine dividend period of twenty years—on May 21, 1910—if the insured was then alive, he or his assigns, if creditors, might surrender the policy and receive its full cash value, or a non-participating policy, payable to the original beneficiary, or if she was not alive, to the executors, administrators or assigns of the insured, or the option was given to keep the policy in force and to withdraw the surplus to the credit of the policy in cash, or use the same to purchase additional insurance."

The bankrupt contended that Section 70 of the Bankruptcy Act did not apply because under the applicable laws of the State of Washington, where he lived, life insurance proceeds were exempt from all liability for debt, and Section 6 of the Bankruptcy Act gave effect to the exemption laws of the several states. The argument made to this court was that the tontine fund was not properly "life insurance" and hence such proceeds were not exempt under

the Washington statute, which argument is summarized by this court at page 209 of its opinion as follows:

> "The arguments supporting this contention are somewhat involved, but are all embraced in the following propositions: First, life insurance, it is said, in its strictest and technical sense, relates only to a fund realizable by death, and therefore the words 'all life insurance,' in the Washington statute, must be given that restricted meaning, hence the statute is inapplicable to one of the policies which partakes of the nature of an endowment," etc.

Such argument was disposed of at page 210 of this court's opinion where it is said:

> "The error in the argument is manifest. It is not to be doubted that the broad terms of the statute, as ordinarily understood, embraced both of the policies, and it would not be construction but legislation to restrict the meaning of the statute in accord with narrower legislation in other States, because in the judgment of a court it might be deemed equitable to do so."

That the proceeds of the tontine element of an insurance policy are "life insurance" and not some other species of property is also clearly recognized in another bankruptcy case, *Hiscock* v. *Mertens,* 205 U. S. 202, 213, which also involved conflicting claims of the bankrupt and the trustee in bankruptcy, the latter claiming that the bankrupt should be required to assign the insurance policies to him because of the absence of any express provision for a cash surrender value, whereas the bankrupt contended that the trustee was entitled to no more than the actual cash surrender value under the existing practices of the company, which amount he had tendered to the trustee. The policies in question were described in the master's report incorporated at pages 206-207 of this court's opinion as follows: "None of these express any agreement or provision whereby upon default the company shall pay a 'cash surrender value' to any person. By their terms the assured is excluded from any participation in dividends until the completion

of the tontine period, at which time all surplus and profits derived from such policies are to be divided among the persistent policies of that class then in force. At the expiration of the tontine period the persistent policy holder is given certain options, among them to withdraw in cash the policy's entire share of the assets, that is, the accumulated reserve, the amount of which is stated in each policy, and, in addition, the accumulated surplus apportioned to the policy."

The trustee was anxious to procure the policies because of the augumented value attributable to the tontine element which was not considered in determining the cash surrender value. At page 213 this court said:

> "Manifestly a policy cannot be declared in or out of the law according to its age, nor can anything be deduced from the investment features of tontine policies. Such policies were decided to be covered by the law in *Holden* v. *Stratton*. Whether the law should have included them is not our concern. Whatever may be said against it, it has seemed best to the legislature to encourage the extra endeavor and sacrifice which such policies may represent."

It was similarly argued in the case of *Briggs* v. *McCullough*, 36 Cal. 542, that the endowment proceeds of a ten year endowment policy were not insurance but simply the proceeds of "a covenant by the company, that in consideration of a certain sum deposited by McCullough, the company will pay him at the expiration of ten years, or sooner, if he dies, a certain other stipulated sum." It was also contended that such proceeds were consequently not within the protection of the California Statute which specifically exempted insurance proceeds from attachment. The court said at page 550:

> "The term 'life insurance' is not alone applicable to an insurance for the full term of one's life. On the contrary, it may be for a term of years, or until the assured shall arrive at a certain age. * * * It is an un-

> dertaking to pay the stipulated sum if he shall die within a specified term, which is of the very essence of life insurance. The fact that the company is to pay the agreed sum at the expiration of ten years, even though McCullough shall not have died in the meantime, does not divest it of its character of life insurance."

The principal difference between the endowment plan which is universally upheld and the semi-tontine or survivorship investment plan which petitioner now questions is that in the former a *fixed* sum is payable to the insured in the event of survivorship, whereas, under the latter, the endowment cannot be computed until the expiration of the tontine period, and it may be lost in the event of the death of the insured during such period.

Semi-tontine policies were involved in an income tax case before this court, *New York Life Ins. Co.* v. *Edwards*, 271 U. S. 109. In that case the insurance company contended, on the supposed authority of *Penn Mutual* v. *Lederer, Collector*, 252 U. S. 523, that the "overpayments" on mutual, level premium, deferred dividend policies should be deducted in determining the premium receipts which formed an element of the gross income in computing the insurance company's net taxable income. As appears at the end of page 115 in the *New York Life Insurance* case, the "deferred dividend" or "distribution" policies provided—"That no dividend or surplus shall be allowed or paid upon this policy, unless the insured shall survive until completion of its distribution period, and unless this policy shall then be in force. That surplus or profits derived from such policies on the distribution policy plan as shall not be in force at the date of the completion of their respective distribution periods, shall be apportioned among such policies as shall complete the distribution periods." Clearly, such deferred dividend policies were semi-tontine policies precisely like the survivorship investment policies now under consideration. In the prior case of *Penn Mutual Co.* v.

Lederer, Collector, (252 U. S. 523) this court had held that where mutual life insurance "overpayments" had been paid back or credited to the individual policyholders or treated as an abatement of premium of such policyholders, the amount thereof should not be included in the company's income. In the *New York Life Insurance Company* case, 271 U. S. 109, however, this court at page 116 held otherwise with respect to the deferred dividend policies, for the sole reason that, under the policy provisions above quoted, no part of the overpayment was repaid or credited to the policyholder but that

> "the aggregate of all such payments was held for distribution among policyholders alive at the end of the period. The receipts for the year were not really diminished."

In the *Penn Mutual* case, 252 U. S. 523, this court, at the bottom of page 532, couples "'Deferred Dividend' and other semi-tontine policies." In neither of the above two cases does this court intimate that a semi-tontine policy does not provide for *insurance* or for *life* insurance.

The validity of the tontine type of contract was directly attacked and sustained in Illinois in the case of *Rothschild* v. *New York Life Insurance Co.,* 97 Ill. App. 547. In that case the holder of several policies on the tontine plan (described as "the accumulation plan"—page 549) under which the reserve was distributable upon twenty-years' survivorship, filed a bill at the end of five years to set aside the policies, alleging that he had been misled as to their nature and had just ascertained "that said policies are cunningly devised gaming contracts, etc." (p. 551.) By the bill, complainant also sought to recover the amount of his contribution to the tontine or accumulation fund. Complainant also relied upon the statutory provision which "requires distribution of surplus at least once in every five years" (p. 555), and also "that a discrimination as to the

distribution of the surplus is made in favor of those who survive April 4, 1915, the accumulation period, and against those who may die before that time; that the former are to be regarded as one class and the latter another." The Illinois Appellate Court held the policies not subject to any of the foregoing objections. At page 556 the court says:

> "There is no discrimination against any member. Each member, in so far as surplus is concerned, makes the same contract. It is the same in principle as if each member contracted for a sum certain in the event of his death, plus a certain percentage of such sum, in case he should survive April 4, 1915.
>
> Lastly, it is contended that the effect of the provision as to the accumulation period, April 4, 1915, and the provision that no dividend shall be apportioned or paid before the end of that period, is that each policy holder bets with all the others that he will survive April 4, 1915, and therefore the provisions are in violation of section 131 of chapter 38, Hurd's Rev. Stat. 1899, in respect to gaming contracts. We can not concur in the view that the contracts are wagers or bets within the meaning of section 131. Section 134 of the same chapter is as follows:
>
> 'Nothing contained in sections 131 and 132 above, shall be (so) construed as to prohibit or in any way affect any insurance made in good faith for the security or indemnity of the party insured and which is not otherwise prohibited by law, nor to any contract of bottomry or *respondentia.*'
>
> The averments of the bill do not sustain the view that appellant's contracts of insurance were not made in good faith for his security or indemnity; and, as we have already held, they were not prohibited by law."

Inferentially, the validity of tontine policies was sustained by the Illinois Supreme Court in *Townsend* v. *Equitable Life Society,* 263 Ill. 432, in which the court held that a bill for an accounting by a surviving member of the tontine class was not vulnerable to demurrer where it was alleged that the distribution made by the company was not equitable and in accordance with the plan.

At the present time, few, if any, strictly tontine policies are issued because of the non-forfeiture laws of most states forbidding the forfeiture of life insurance policies after two or three years' premiums have been paid. This has brought about a modification of the tontine plan which is now usually coupled with and embodied in an ordinary life insurance policy, the principal proceeds of which are payable upon death. This plan of insurance is known under divers names, such as semi-tontine, survivorship investment policies, investment reserve policies, accumulation reserve policies, etc. The theory underlying the modern tontine policy is set forth in the definition of the word tontine in the Century Dictionary, as follows:

> "This modification of ordinary life insurance has been adopted as optional with the insured for the purpose of countervailing the tendency to burden long lived and persistent policy holders with a large amount of premiums in comparison with those whose lives fall in shortly after obtaining insurance. The effect is to reduce the sum payable on deaths after but few years payment of premiums and to increase the sum payable on deaths occurring after a given number of years."

The tontine element of such semi-tontine life insurance contracts is a feature designed to make the life insurance investment more attractive to the person of exceptionally long lived stock whose actual expectancy can reasonably be presumed to exceed the ordinary expectancy of his age, upon which the premiums are based, and to make the possible investment gain to him upon survivorship commensurate with the excessive cost to him because of the computation of the premium upon such ordinary shorter expectancy. While it is true that upon the hearings before the New York Insurance Investigating Committee in 1905, the eminent counsel for the Joint Committee, now the Chief Justice of this Court, questioned the economic wisdom and necessity of this type of policy, the fact remains that under the Illinois Legislative Act of 1907, adopted to remedy

certain abuses disclosed at the New York hearing, this type of policy remains a valid policy under the Illinois law, and it must be left to the judgment of the insured whether he desires this type of policy, an ordinary life insurance policy, an endowment policy, an annual dividend policy, some other type of policy, or no insurance whatever.

III.

NEITHER BY THE REVENUE ACT NOR BY THE DECISION OF THIS COURT IN HELVERING v. INTER-MOUNTAIN LIFE INSURANCE CO. IS THE PHRASE "RESERVE FUNDS REQUIRED BY LAW" SO LIMITED AS TO EXCLUDE INSURANCE RESERVES REQUIRED AND SET UP TO COVER INSURANCE LIABILITIES WHICH SHALL ACCRUE UPON CONTINGENCIES OTHER THAN THE CONTINGENCY OF DEATH, SUCH AS THE LIABILITY FOR ENDOWMENT AND TONTINE PAYMENTS, BOTH OF WHICH ARE DEPENDENT UPON SURVIVORSHIP OF A FIXED DATE.

There is no contradiction of Petitioner's assertion that the terms "reserve" and "reserve funds required by law" do not, for the purpose of determining income tax deductions, embrace all reserves established by an insurance company, nor even all reserves which the law or an administrative official may require an insurance company to set up. It may be assumed, also, that the deduction is to be confined only to such reserves as are required to meet an insurance liability. It is not correct, however, to say that a reserve is deductible only if computed on the basis of *mortality tables* plus an assumed rate of interest. It is true that the reserves for life insurance payable upon the event of death are computed upon the basis of mortality tables, but that is only because the mortality table is the most accurate gauge for determining the probable date of the maturity of that particular obligation. If the maturity of an insurance obligation is, by contract, fixed at a definite date in the future, there is, of course, no occasion to con-

sult or employ mortality tables. The question, therefore, is not what mechanics are adopted for determining the approximate maturity or the amount of the reserves, but is whether the reserve is an *insurance* reserve or some other kind of reserve. It is true that if the reserve is not an insurance reserve but a mere solvency reserve (such as will be discussed in greater length hereinafter) it is not deductible. This brings us back, therefore, to the question of whether the company's obligation upon a semi-tontine insurance policy is an insurance obligation, which question has been discussed in the preceding section of this brief. There is nothing in the decision of this court in *Helvering* v. *Inter-Mountain Life Insurance Co.* 294 U. S. 686, or in any other decision of this court, at variance with the Respondent's contentions. To present a clearer exposition of the development of the law, we shall discuss the earlier decisions of this court in chronological order.

McCoach v. *Insurance Company of North America,* 244 U. S. 585, decided June 11, 1917, was an action brought by the insurance company to recover a part of the excise taxes exacted from it under the Capital Stock Tax Act of 1909. The act imposed a tax measured by the net income over $5,000, and defined net income as the gross income less enumerated deductions including, in the case of insurance companies (not restricted to life insurance companies), "the net additions, if any, required by law to be made within the year to reserve funds."

The Commissioner under these statutes required the taxpayer to show the net amount of unpaid losses and claims as an item among its liabilities. The Supreme Court distinguished between amounts required to be held against unpaid losses under the Pennsylvania act and "reserves" within the meaning of the act of Congress. At page 589, the court, per Mr. Justice Pitney said:

"Conceding full effect to this, it still does not

answer the question whether the amounts required to be held against unpaid losses, in the case of fire and marine insurance companies, are held as 'reserves,' within the meaning of the Pennsylvania law or of the act of Congress, however they may be designated upon the official forms. As already appears, *the Pennsylvania act specifically requires debts and claims of all kinds to be included in the statement of liabilities and treats them as something distinct from reserves.* The object is to exercise abundant caution to maintain the companies in a secure financial position.

The act of Congress, on the other hand, *deals with reserves* not particularly in their bearing upon the solvency of the company, but *as they aid in determining what part of the gross income ought to be treated as net income for purposes of taxation.* There is a specific provision for deducting 'all losses actually sustained within the year and not compensated by insurance or otherwise.' And this is a sufficient indication that losses in immediate contemplation, but not as yet actually sustained, were not intended to be treated as part of the reserve funds; that term rather having reference to the funds ordinarily held as against the *contingent liability on outstanding policies.*

In our opinion the reserve against unpaid losses is not 'required by law,' in Pennsylvania, within the meaning of the act of Congress.'' (Italics supplied.)

The analogy drawn at the end of the second paragraph quoted, between the deduction for losses actually sustained and losses in immediate contemplation, is an apt and interesting one, such losses, as the court points out, not being a ''contingent liability on outstanding policies'' and the word ''reserves'' as employed in the Capital Stock Tax Act, ''having reference to the funds ordinarily held as against the contingent liability on outstanding policies.''

The liability of the Illinois Life Insurance Company respecting the investment feature of the survivorship investment fund policies was clearly of the latter class—*i. e.*, ''contingent liability on outstanding policies,'' and not of the former class, ''losses actually sustained within the

year" or "losses in immediate contemplation, but not as yet actually sustained."

In the Inter-Mountain Insurance Company case, however (more fully discussed at page 27, *infra*) the liabilities in question were of the former class, for the court there was dealing with liabilities upon matured coupons which the insured could, within the taxable year, turn in in exchange for cash. In other words, the coupons represented liabilities actually sustained within the year.

Maryland Casualty Co. v. *United States*, 251 U. S. 342, decided January 12, 1920, was an action by an insurance company engaged in writing employers' liability and other branches of insurance, but not including life insurance, to recover income taxes under the 1913 Act and excise taxes under the 1909 Act theretofore paid by the company.

We are interested only in the second and third essential questions decided by this court. These questions are stated at pages 344-345 as follows:

> "(2) May the amount of gross income of the claimant be reduced by the aggregate amount of the taxes, salaries, brokerage and reinsurance unpaid at the end of each year, under the provisions in both the excise and income tax laws allowing deductions of 'net addition, if any, required by law to be made within the year to reserve funds'?
>
> (3) Should the decrease in the amount of reserve funds required by law for the year 1913 from the amount required for 1912 be treated as 'released reserve' and charged to the company as income for 1913?"

At page 348, this court points out:

> "In the same words the Excise and Income Tax Acts provide that 'the net addition, if any, required by law to be made within the year to reserve funds' may be deducted from gross, in determining the amount of net, income to be taxed."

At page 350, the court said, per Mr. Justice Clarke:

> "The term 'reserve' or 'reserves' has a special

meaning in the law of insurance. While its scope varies under different laws, in general it means a sum of money, *variously* computed or estimated, which with accretions from interest, is set aside, 'reserved,' as a fund with which to mature or liquidate, either by payment or reinsurance with other companies, *future unaccrued and contingent claims, and claims accrued, but contingent and indefinite as to amount or time of payment.*" (Italics supplied.)

Nothing in the foregoing language was modified or limited by the subsequent decision of this court in *United States* v. *Boston Insurance Co.*, 269 U. S. 197.

The reserves in question in the case at bar are, within the foregoing language, contingent and indefinite as to amount. At page 351, the court said:

> "That provision for the payment of ordinary expenses such as we are considering was not intended to be provided for and included in 'reserve funds' as the term is used in the acts of Congress is plain from the fact that the acts permit deductions for such charges from income if paid within the year."

The reserves here in question obviously do not fall within the class above indicated, for there is nothing in the Revenue Act of 1928 which authorizes the deduction of such survivorship investment fund payments in the years in which made. Section 203 (a) (5) permits the company, in determining net income, to deduct from gross income "investment expenses paid during the taxable year." By no stretch of the imagination can the survivorship investment fund, held by the company exclusively for the benefit of the holders of policies of that class, be regarded as an investment expense. That phrase must rather be restricted to such items as taxes, salaries, brokerage, and reinsurance as were involved in the Maryland Casualty Company case.

As to the third question involved in the Maryland Casualty Company case, it appeared that the "unpaid lia-

bility loss reserve" decrease in 1913 exceeded the "unearned premium reserve" increase, and the government contended that such excess, which it designated "released reserve," must be added to gross income for 1913 on the theory that it in that year became "free income;" and that the company then, for the first time, "could use it for its general purposes" (page 351). At page 352, this court said:

> "Reserves, as we have seen, are funds set apart as a liability in the accounts of a company to provide for the payment or reinsurance of specific, contingent liabilities. They are held not only as security for the payment of claims but also as funds from which payments are to be made."

The reserves in question in the present case are strictly funds set apart to cover contingent liabilities as above defined.

At page 352, this court continued:

> "If, in this case, it were due to an over estimate of reserves for 1912 with a resulting excessive deduction for that year from gross income and if such excess was released to the general uses of the company and increased its free assets in 1913, to that extent it should very properly be treated as income in the year in which it became so available, for the reason that in that year, for the first time, it became free income, under the system for determining net income provided by the statute, and the fact that it came into the possession of the company in an earlier year in which it could be used only in a special manner, which permitted it to become nontaxable would not prevent its being considered as received in 1913 for the purposes of taxation, within the meaning of the act."

Clearly, the additions to the survivorship investment fund in the case at bar never became "free income" of the taxpayer, and never were "released to the general uses of the company," and never "increased its free assets." Incidentally, in the Maryland Casualty Company case, this

court also held against the Government on the third question because of a lack of any showing that the excess had been released "to the free beneficial use of the company in a real, and not in a mere bookkeeping sense," and that the deduction in prior years had been "restored to the free use of the claimant in 1913." There is, of course, no conceivable theory upon which it can be contended that the additions to the survivorship investment fund in question were ever "free income" of the company, or were ever released to the company "in a real, and not in a mere bookkeeping sense," or were ever "released to the general uses of the company," or ever "increased its free assets." The only conceivable theory upon which the company could ever realize these reserves as "free income," is upon the wild conjecture that every member of the tontine class should have died or permitted his policy to lapse before the expiration of the tontine period and, in such almost impossible event, the company would then realize a taxable income, but never before that time.

United States v. *Boston Insurance Company,* 269 U. S. 197, decided November 23, 1925, was precisely like *McCoach* v. *Insurance Company of North America,* excepting that the tax involved was an income tax under the 1916 Act instead of an excise tax. The claimant carried on the business of issuing fire and marine insurance policies, but the 1916 Act did not distinguish between life insurance and other insurance companies. At page 202, this Court, per Mr. Justice McReynolds, referred to the controlling case of *McCoach* v. *Insurance Company,* and said:

> "We there distinctly ruled that the 'reserve fund' of the Federal Act did not include something held by a fire and marine insurance company to cover *accrued but unsettled claims for losses.*"

The last sentence might have been amplified by including also companies issuing life insurance policies. It is

sufficient to say that the survivorship investment reserve fund involved here did not cover an "accrued but unsettled claim for losses." And it must be borne in mind that the reserves covering matured coupons, as were involved in the *Inter-Mountain Insurance Company* case, did cover that very thing—an accrued but unsettled claim which the insured had the immediate right to convert into dollars upon surrendering his coupons.

New York Life Insurance Company v. *Edwards*, 271 U. S. 109, decided April 19, 1926, was an action by a life insurance company to recover a portion of the income tax paid for the year 1913. Of the five questions considered by the Supreme Court only two are even remotely related to the question in the case at bar.

The 1913 Act contained the proviso:

> "That * * * life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year * * *." (Page 115.)

The Insurance Company, a New York corporation without capital stock, did business on the mutual, level-premium plan and issued, among others, "deferred dividend" policies. These closely resembled the survivorship investment fund policies involved in the case at bar and provided:

> "That no dividend or surplus shall be allowed or paid upon this policy, unless the insured shall survive until completion of its distribution period, and unless this policy shall then be in force. That surplus or profits derived from such policies on the distribution policy plan as shall not be in force at the date of the completion of their respective distribution periods, shall be apportioned among such policies as shall complete the distribution periods. (Page 115.)

The company contended that the entire amount of the

deferred dividend should be deductible. This contention is disposed of by the court, per Mr. Justice McReynolds, at page 116 as follows:

> "It is insisted that within the meaning of the quoted provision [the proviso above quoted] each deferred dividend policyholder's overpayment was actually credited to him during the year; but we cannot accept this theory. The aggregate of all such payments was held for distribution among policyholders alive at the end of the period. *The receipts for the year were not really diminished.*"

It will be perceived that that case involved an attempted deduction of the entire amount of deferred dividends and not merely of reserves or a portion of the reserves required by law for such deferred dividends. There is nothing in the report to indicate that any such reserve was either maintained or required. The last sentence quoted "the receipts for the year were not really diminished" indicates that no such reserve was required. In the case at bar, however, the statute specifically required the maintenance of the reserves in question and to the extent that the reserves were maintained, the receipts (free income) were really diminished.

At page 119, this court considered the deductibility of a special fund to meet unreported losses of policyholders dying during the calendar year, which special fund the Superintendent of Insurance required to be set aside. On authority of the McCoach and Boston Insurance Company cases the court held that these "reserves" were not such as were required by law within the meaning of the Internal Revenue Act. Referring to the McCoach and Boston Insurance Company cases, this court said at page 119:

> "It is unnecessary now to amplify what was there said. The item under consideration represented a liability and not something reserved from premiums to meet policy obligations at maturity."

The item in the case at bar does not fall within the fore-

going description since it does not represent an immediate liability, but, on the contrary, is "something reserved from premiums to meet policy obligations at maturity," and is contingent both as to identity of the policyholders at the termination of the tontine period, and the amount then to be distributed.

Finally we come to the recent decision of this court in *Helvering* v. *Inter-Mountain Life Insurance Co.* 294 U. S. 686, decided April 1, 1935. That case involved the deductibility of a percentage of reserves required by statute to be set aside to cover the liability upon matured coupons which upon their maturity had ceased to be contingent liabilities and had become debts immediately payable to the policyholders or subject to application as the policyholders' funds in the manner specified in their policies.

The pertinent facts were stated by Mr. Justice Butler at page 688 as follows:

> "The record contains a specimen policy for $10,000 applicable to age 35, issued in consideration of 20 annual premiums of $420.90. Attached are 19 coupons maturing serially on anniversary dates of the policy, beginning with the first and ending with the nineteenth. Each coupon is a promise that at its maturity the company will pay the amount specified to the owner of the policy.
>
> The policy states: The company will credit insured the face amount of any matured coupon as it becomes due and pay compound interest thereon, thereby creating a fund to the credit of the insured which may be applied to the payment of premiums or *at any time withdrawn in cash;* and if not so applied or withdrawn prior to his death, it will pay the coupon values with interest to date of death to the beneficiary in addition to the face amount of the policy." (Italics supplied.)

It will at once be perceived that "each coupon is a promise that at *its* maturity the company will pay the amount specified." This single sentence illustrates the wide divergence of the two cases. In a case involving reserves against ma-

tured and unpaid coupons there is a fixed and definite liability *immediately payable* upon the maturity of each coupon. When that day arrives all element of contingency vanishes and the insurance company immediately becomes a debtor in the amount specified. It is true that the insured has certain options even under the coupon plan, but those options only relate to the application which shall be made by the insurance company of the moneys in its hands belonging to the insured. The gist of the decision in the *Inter-Mountain Life Insurance Company* case is that the only reserves properly deductible are those providing for *contingent* liabilities, whereas the liability of the insurance company upon *matured coupons* is not contingent, or as this court said: "Liability on the matured coupons depends upon no contingency." This is obviously true, and it is equally obvious that the liability of the respondent upon its survivorship investment policies is contingent. The two plans are wholly different. The matured coupons involved in the *Inter-Mountain Insurance Company* case represented actual *immediate* liabilities of the insurance company and debts actually then due and owing from the insurance company to the coupon-holders. The liability of the respondent under the policies here involved is, however, a *future* and *contingent* liability which may or may not at some future date ripen into an indebtedness to the insured.

In 1 Cooley's Briefs on Insurance (2nd Ed., 1927), it is said at page 172:

> "Until the expiration of the tontine period, the liability of the company is contingent (*Avery* v. *Equitable Life Assur. Soc.*, 117 N. Y. 459, 23 N. E. 3). On the expiration of the period, the relation of debtor and creditor arises."

The several cases cited by that author amply support the text. The same author continues at page 172:

> "So, where the insured died a short time before the

> expiration of the period, his beneficiary was entitled to no share in the tontine fund."

That is, of course, quite different from the liability of the insurance company in the *Inter-Mountain Insurance Company* case, for in that case there was a debtor-creditor relationship immediately upon the maturity of the several coupons and had insured died before payment of any such matured coupon the company would have remained *pro tanto* liable to his estate but for the presence of a clause in the policy making the amount payable to the beneficiary.

The distinction we have pointed out between the rights of the tontine policyholders in the case at bar and the rights of the holders of matured coupons in the *Inter-Mountain Life Insurance Company* case is borne out by the language of this court in *Duffy* v. *Mutual Benefit Co.*, 272 U. S. 613. That was a proceeding involving the determination of the insurance company's excess profits tax, the specific question being whether the legal reserves set up by the company constituted "invested capital." The insurance company contended that they did not constitute capital, but represented an existing liability. The Supreme Court held otherwise, however, saying at page 618:

> "These assets, thus constituted, have never represented indebtedness any more than the capital of a stock corporation subscribed by its stockholders represents indebtedness. Until the maturity of a policy, the policyholder is simply a member of the corporation, with no present enforceable right against the assets. Upon the maturity of the policy he becomes a creditor with an enforceable right. Then for the first time there is an indebtedness. See *Mayer* v. *Attorney General*, 32 N. J. Eq. 815, 820-822."

This very distinction exists in the cases we are now considering. In the *Inter-Mountain Life Insurance Company* case the coupons involved had matured so that the policyholders had become creditors and there was an existing indebtedness. In the case at bar, however, the policies had not matured, and prior to the expiration of the tontine pe-

riod the policyholders had no present enforceable rights against the assets of the company. Whether or not they ever would obtain such rights in the future is involved in the contingencies of survivorship and persistence.

It thus appears that the *Inter-Mountain Life Insurance Company* case is in no respect parallel with the case at bar and is valueless as authority under the facts involved in the present case. Inasmuch as petitioner's entire case is founded upon the supposed authority of the *Inter-Mountain Life Insurance Company* decision, petitioner's case is not supported by any authority. On the other hand, the facts involved take the present case outside the express limitations announced in the rule in the *Inter-Mountain Life Insurance Company* case wherein this court predicated its decision on the fact that the case involved the deductibility of reserves for *matured coupons*. These the court held to be an *immediate* fixed indebtedness, free from any contingency, whereas in the present case there can be no actual liability of the company to pay until the expiration of the tontine period, and even then such liability as to each member of the class is contingent upon survivorship and persistence.

There is, however, one sentence in the opinion of this court in *Helvering* v. *Inter-Mountain Insurance Co.* which may need clarification. At page 690 it is said:

> "Life insurance matures only upon the death of the insured and the life reserve is based upon that contingency, whereas liability on the matured coupons depends upon no contingency."

We think it a fair assumption that in employing this sentence the court meant to cover the insurance company's full liability under its policy, both contingent and non-contingent. It is evident, however, that there is an excluded middle ground not embraced in that sentence—*i. e.*, a contingent liability maturing upon a contingency other than

death. If the opening words of the sentence, "life insurance matures only upon the death of the insured," were taken as literally true, then the court must have held, contrary to all earlier decisions, that an endowment policy, which also matures upon survivorship instead of death, is not a life insurance policy. Obviously, the controlling factor in the Inter-Mountain Insurance Co. decision is not found in the opening words of the last quoted sentence—that the coupons did not mature upon death—but rather in the closing words of the same sentence—"liability on the matured coupons depends upon no contingency." This reading of the said sentence brings it into harmony with all the earlier decisions of this and other courts. The foregoing is perhaps a rather lame way of restating what the Circuit Court of Appeals said in its opinion in this case. (Printed Record, Pages 33-34)

> "It is said that the words of the Supreme Court in the Inter-Mountain case defining life insurance reserves are to be construed strictly and that we must eliminate from deductible reserves all funds that are not within the original and elemental meaning of life insurance."
>
> • • • • • •
>
> "Strictly speaking, perhaps, life insurance does not necessarily include guaranteed cash surrender values. Rather, if we speak literally, life insurance probably includes only policies of insurance, the provision of which is that in case of death, while the policy is in full force and effect, the face thereof shall be paid. But as insurance has developed, life insurance has come to mean more than mere payment of losses in case of death. It has come to include cash surrender values, guaranteed loan values, dividend, endowment, and tontine funds and other similar variations of the original insurance contract, brought into existence and embodied in insurance contracts to protect the insured, not only in case of death, but also, in case of survivorship. All cash surrender values, guaranteed loan values, tontine, endowment, and dividend payments are payable, not because of death, but because of invest-

> ment of premiums for the benefit of an insured who has survived; and if we begin to eliminate such of these funds as represent the accumulation of investment of premiums, in the end we shall be compelled logically to eliminate all of them and also to limit our definition of 'reserves required by law' to such reserves only as are created as a fund against the payment of death claims. This we do not believe was the intent of Congress; nor do we believe that the Supreme Court intended such construction of the statutory language in the Inter-Mountain case."

That Congress did not regard the contingency of death as the sole or essential controlling factor in determining the deductibility of reserves is manifest from other provisions of the 1928 Revenue Act. For example, Section 203 (a) (2) itself provides for the deduction of reserve funds even though "not required by law" in the case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan continuing for life, and not subject to cancellation, and Section 203 (a) (4) expressly provides for a reserve for deferred dividends as follows:

> "An amount equal to two per centum (2%) of any sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year), the payment of which is deferred for a period of not less than five (5) years from the date of the policy contract."

By this latter section, Congress has expressly authorized the deduction of a reserve for a liability much more closely approximating such a fixed immediate liability as arose upon the matured coupons in the Inter-Mountain Insurance Company case than does the liability of the respondent upon the survivorship investment policies involved in the case at bar. The deferred dividends covered by Section 203 (a) (4) are liabilities definite both in amount and as to identity of obligee but merely deferred as to date of pay-

ment, whereas respondent's Survivorship Investment Fund liabilities are deferred as to date of payment and *contingent* in amount and as to identity of obligee. Manifestly, the Congress inserted Section 203 (a) (4) only because deferred dividends of the type included therein were not contingent liabilities and the Congress considered the element of contingency as the determinative factor in distinguishing life insurance reserves from solvency reserves.

Illinois Statutes.

Commencing on page 19 of the brief for the Petitioner, attention is directed to Section 10 of the Act of March 26, 1869, as Amended, which required the Department of Trade and Commerce to make annual valuations of outstanding policies, etc., on the basis of prescribed mortality tables with a prescribed rate of interest. This valuation furnishes the basis for determining the reserve required upon that element of the insurance obligation maturing upon death. There is nothing in the statute or out of the statute, however, which would prevent any other required reserve from being a life insurance reserve. The fact that the Illinois statute requires certain life insurance reserves to be computed upon the basis of mortality tables and prescribed interest rates does not demonstrate that reserves required to be computed upon any other basis are not life insurance reserves. The fact is, of course, that prior to the upheaval in the insurance business in the early nineteen hundreds, insurance companies were required to maintain reserves only upon those life insurance obligations which matured upon death and which consequently were computed on the basis of mortality tables and prescribed interest rates. They also wrote life insurance upon the deferred dividend plan—upon the tontine plan—upon the semi-tontine plan—and other forms of life insurance as to which the statutes of practically all

states were silent as to maintenance of reserves and the safeguarding of the obligations contingently due to the insured in the event of survivorship. It was not questioned then, and we believe it is not questioned now, that such obligations were in every sense of the word insurance obligations, even though they matured not upon death but upon survivorship, and, in fact, were contingent upon survivorship. Then, when as a result of the labors of the Frick Investigating Committee, the series of law suits against the Equitable Life Assurance Society and others, and finally the disclosures before the New York Insurance Investigating Committee, the unfair practices of insurance companies in this and other respects became generally known, the insurance laws of New York, Illinois, and most other states were amended to remedy the existing abuses. Upon the recommendation of the Investigating Committee, the New York insurance laws prohibited the writing of nonparticipating insurance policies. The Illinois legislature did not go quite so far and allowed nonparticipating semi-tontine policies to be written, provided that certain reserves were maintained to guarantee payment at maturity. Whereas formerly the premium collected from the nonparticipating semi-tontine portion of the policy could be carried in the company's general surplus where it might easily be dissipated in any of the numerous ways disclosed at the New York Committee hearings, the statute of May 20, 1907 required the maintenance of reserves which could not be so dissipated. Of course, the new Act did not require that the reserves be based upon mortality tables, for what sense could there be in requiring the employment of mortality tables where the maturity date of the obligation is specifically fixed by the contract! The new Act did, however, require the maintenance of reserves to safeguard what had until then been regarded and still are regarded as insurance obligations. The pertinent portion

of the Act in question has been set forth hereinbefore at page 5.

Conclusion.

The statutes and authorities sustain the following conclusions:

1. That the Survivorship Investment Fund policies issued by the Respondent are life insurance policies with respect to the benefits payable upon survivorship as well as with respect to the benefits payable upon death.

2. That the liability of the Respondent with respect to the survivorship benefits is an insurance liability contingent upon the insured surviving the tontine period and persisting in the payment of premiums for such period.

3. That the Illinois Statute requires the maintenance of the reserve which the Respondent has established to mature such survivorship liability.

4. That the reserves required by law to safeguard contingent liabilities, as distinguished from mere solvency reserves to protect immediate non-contingent liabilities resulting from operation or investments, are within the purview of Section 203 (a) (2) of the Revenue Act of 1928, and are deductible in determining taxable net income of life insurance companies for the year 1929.

5. That the Survivorship Investment Fund Reserve maintained by the Respondent pursuant to the express requirements of the Illinois Statute are such contingent insurance reserves and are deductible as aforesaid.

It is therefore respectfully submitted that the decision of the Court below should be affirmed.

Roy O. West,
Percy B. Eckhart,
William M. Klein,
Samuel B. Kraus,
Attorneys for Respondent.

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IN THE

Supreme Court of the United States

No. 27

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

ILLINOIS LIFE INSURANCE COMPANY,
Respondent.

PETITION FOR REHEARING.

ROY O. WEST,
PERCY B. ECKHART,
WILLIAM M. KLEIN,
SAMUEL B. KRAUS,
Attorneys for Respondent.

THE BUNTHORP-WARREN PRINTING COMPANY, 310 WEST JACKSON, CHICAGO

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PETITION FOR REHEARING.

Comes now the above-named respondent, Illinois Life Insurance Company, and presents this, its petition for a rehearing of the above entitled cause, and, in support thereof, respectfully shows:

1. This Court apparently has misconceived the facts and the extent of its decision at the last term of Court in *Helvering* v. *Inter-Mountain Life Insurance Company,* 294 U. S. 686, upon which the opinion heretofore filed herein was based.

2. This Court seems to have misapprehended the points of difference and the points of resemblance between the insurance company's liability for survivorship investment benefits payable upon survivorship, and death benefits payable upon death.

3. We believe that this Court has failed to perceive the

purpose of Congress in allowing life insurance companies to deduct a percentage of the mean reserves required by law in determining taxable net income.

4. It is submitted that the decision filed herein reads into the law limitations upon the right to deduct such reserves, which are not contained in the law and are in conflict with the purpose and intent of Congress in enacting the law.

In support of the foregoing assertions we respectfully direct this Court's attention to the following:

I.

The Inter-Mountain Life Insurance Company Case.

In the second sentence of the second paragraph of the opinion of the Court herein as it was originally printed and published it was said that the clause of Section 203 (a) (2) of the Revenue Act of 1928, which allows life insurance companies to deduct, *inter alia*, an amount equal to 4 per cent of the mean of the reserve funds required by law and held at the beginning and end of the taxable year, "is a re-enactment of Section 245 (a) (2), Revenue Act of 1921, which in *Helvering* v. *Insurance Co.* we held not to apply to assets reserved by a life insurance company against **unmatured**, unsurrendered and unpaid coupons attached to its policies." The coupons involved in the *Inter-Mountain Life Insurance Company* case, 294 U. S. 686, were *matured* coupons, and not unmatured coupons as stated in the opinion filed herein, on November 9th. On November 12th, we asked the Clerk of this Court whether the word "unmatured" in the opinion published in United States Law Week for November 10th was correct, and the Clerk advised us that it was the same as in the printed opinion on file in his office. We thereupon requested that

he confer with the Secretary of Mr. Justice Butler, who delivered the opinion. After a slight delay, the Secretary advised the Clerk that the printed opinion was erroneous and that the word should have been "matured." By far, the greater part of the brief for the Respondent herein was devoted to distinguishing the *Inter-Mountain Life Insurance Company* case from the case at bar on this very point—*i. e.*, that the reserves involved in the Inter-Mountain Life Insurance Company case covered matured liabilities wholly noncontingent in character, whereas, the reserves for survivorship investment benefits in the present case covered an unmatured liability, which unmatured liability was incidentally contingent upon persistence and survivorship. The error in the use of this word may have been merely typographical but, if it was present in the draft of the opinion considerd by this Court, it may very well be that the Court has wholly misconceived the extent of its prior decision in the Inter-Mountain Life Insurance Company case, and concluded that the Inter-Mountain case and the present case were substantially identical in their facts.

II.

Survivorship Investment Benefits Do Not Differ Essentially From Death Benefits.

Remarks of some of the Justices upon oral argument of this case indicate that the Court started with the assumption that there was a vital difference between the liability of this insurance company for death benefits and the liability for survivorship investment benefits—*i. e.*, that the liability for death benefits is contingent, whereas the liability for survivorship investment benefits is certain and noncontingent, at least when viewed from the standpoint of the insurance company.

It is evident upon further reflection that no such distinction exists. Death is certain and involves no contingency excepting as to the time when it will occur. Even in the case of the death benefit there is consequently neither uncertainty nor contingency as to the ultimate liability of the insurance company. A liability may be contingent in the sense that it is uncertain, and it is dependent upon future events whether the liability will ever become real. No such contingency exists either as to the survivorship investment benefit or as to the death benefit. A liability may be certain to occur, but still be contingent upon future events to determine *when* it will occur, as in the case of death benefits on straight, ordinary life insurance. On the other hand, the liability may be certain as to the date when it will become absolute, but be contingent as to the identity of the obligee, as in the case of the survivorship investment benefit. Of the latter two can it be said that either liability is more fixed or less contingent than the other?

It is submitted that the only proper test is whether or not the liability protected by the reserve has *matured.* If the liability has matured, as in the case of matured coupons or death claims after the death of the insured, then a debtor-creditor relationship exists between the beneficiary and the insurance company and the reserve is merely one for the payment of an existing indebtedness and is a mere solvency reserve. On the other hand, if the liability has not matured, the relationship is that of insurer-insured, and there is no existing indebtedness and the reserve is a contingent insurance reserve and deductible if the maintenance of such a reserve is required by State law.

III AND IV.

The Purpose of Congress in Permitting Life Insurance Companies to Deduct a Percentage of the Mean of Reserves Required by Law.

Apparently this court has overlooked the distinction between life insurance companies and ordinary business corporations—the distinctions which caused Congress to prescribe in the case of life insurance companies an entirely different method of determining taxable net income than that prescribed in the case of other taxpayers. Broadly speaking, in the case of the ordinary taxpayer, all receipts are gross income and to the extent that such receipts exceed losses and business expenses they are net income subject to tax. In the ordinary case, however, all such excess is "free surplus," available to the taxpayer, if a corporation, for dividends or any other corporate purpose. The case of the life insurance company is quite different. Instead of all receipts constituting gross income, Section 202 of the Revenue Act of 1928 limited the term "gross income" to mean "the gross amount of income received during the taxable year from interest, dividends, and rents." This limitation was doubtless imposed in view of the self-evident fact that premium receipts can in no sense be regarded as income inasmuch as they do not inure to the benefit of the insurance corporation, but are held almost entirely for ultimate distribution to the policyholders, and under the various State laws such liabilities are required to be protected by reserves. This feature is closely akin to the situation of a savings bank. Savings deposits are not income, because at the instant the bank has received moneys for deposit there arises a counter-balancing immediate liability of the bank to the depositor. In the case of

the life insurance company, such a liability arises to policyholders with respect to the premium and certain other receipts, excepting that instead of an immediate liability it is deferred and contingent, but under the Illinois law that liability is required to be safeguarded by reserves which prevent the insurer from ever becoming equitably entitled to the funds so set apart.

Under the opinion delivered herein, the insurance company is taxed upon receipts which are never in fact income because, under the Illinois Statute, they are required to be set aside in a reserve for ultimate distribution among the policyholders and no part thereof ever will be available to the corporation for any other purpose.

The rule announced in that opinion, moreover, results in double taxation. The investment income realized upon the survivorship investment funds is first taxed against the insurance company in the year in which the income is received by it. This same income is later again taxed as against the policyholders when the tontine fund consisting of such income and the contributions made by the policyholders is distributed among the surviving persistent members of the class. The policyholders, of course, pay no income tax upon that portion of the payment which represents return of premium or consideration paid, but they are required under the Statute (Revenue Act of 1928, Sec. 22 (b) (2)) to include in their taxable income the excess over such premiums or consideration paid. Such excess, however, will have been taxed theretofore against the insurance company as above shown.

At page 20 of the Brief for Respondent herein, we quoted from this Court's opinion in *McCoach* v. *Insurance Company of North America*, 244 U. S. 585, in part as follows:

> "The Act of Congress • • • deals with reserves not particularly in their bearing upon the solvency of

> the company, but as they aid in determining what part of the gross income ought to be treated as net income for purposes of taxation."

That was the first case before this Court involving the interpretation of a statutory provision akin to the one now before this Court. The Court then recognized the congressional intent to tax only the net income of insurance companies and to disallow only such of the reserves as did not "aid in determining what part of the gross income ought to be treated as net income for purposes of taxation." Any part of the gross receipts which is by law required to be held in a reserve to be returned or paid to the policyholders and can never be available for the general corporate purposes of the company cannot in fairness to insurance companies be treated as net income to those companies either for the purpose of taxation or for any other purpose.

The income which Congress sought to include as taxable income of life insurance companies is such as this Court in *Maryland Casualty Company* v. *United States*, 251 U. S. 342, 352, designated as "free income" or, as the Court there also stated, such as was "released to the general uses of the company and increased its free assets." We respectfully refer this Court to the discussion of the *Maryland Casualty Company* case contained at pages 21-24 of the Brief for the Respondent.

That Congress did not intend to limit the deductible reserves of life insurance companies so as to embrace only those reserves which cover liabilities maturing upon death is manifest from Section 203 (a) (4) of the Revenue Act of 1928, which expressly allows a deduction of

> "An amount equal to 2 per centum of any sums held at the end of the taxable year as a reserve for dividends (other than dividends payable during the year following the taxable year) the payment of which is deferred for a period of not less than 5 years from the date of the policy contract."

Here is a reserve expressly provided for which covers a liability maturing before death. The only distinctions between this and the survivorship investment reserves are that in the case of the reserves for deferred dividends, the period of deferment may be as short as 5 years, whereas in the survivorship investment case the deferment is for 20 years, and the further distinction that in the case of deferred dividends the right to receive the dividends after they are earned by the company is not contingent upon any circumstance, whereas the right to receive any portion of the survivorship investment fund is contingent upon survivorship by the insured. There is, of course, no basic difference between the nature of the fund reserved for deferred dividends and the fund reserved for survivorship investment. Each fund is made up of contributions by policyholders, plus earnings upon investment of the funds, plus accretions from lapsed policies. The incidental distinction mentioned above (that the right to receive deferred dividends is unconditionally vested, whereas, the right to receive the survivorship investment benefit is conditioned upon survivorship and persistence) seems immaterial excepting in that it only the more indelibly stamps the survivorship investment fund as an insurance fund, as compared with the deferred dividend fund.

By almost imperceptible steps in the successive decisions of this Court, the scope of the deduction for reserves, allowed by Section 203 (a) (2) of the 1928 Revenue Act and corresponding sections of earlier Acts, has been narrowed to a degree which Congress never could have contemplated when these sections were enacted. The first portion of Section 203 (a) (2) of the 1928 Act refers only to "reserve funds required by law" and is not expressly limited to life insurance reserves nor, for that matter, even to insurance reserves. We have no quarrel with the restrictions

imposed by the successive decisions of this Court limiting such deductions to insurance reserves as distinguished from solvency reserves, and even the decision in the Inter-Mountain Life Insurance Company case limiting such insurance reserves to those which cover unmatured contingent obligations. But the line in the process of construction must be drawn somewhere. And we believe that this line has been overstepped in the opinion filed herein where the Court also excludes what are unquestionably reserves—what are reserves required to be maintained under the laws of Illinois—and what are reserves covering an insurance obligation under a life insurance policy. No single decision on this question has been a radical departure from the rule announced in any preceding decision. But when the rule to be deduced from the opinion heretofore filed herein is compared with the language of the Statute, it is evident that the taxing provisions of the Statute are by implication extended beyond the import of the language used in the Statute, to embrace in taxable income what is not so specifically required by the Statute.

Even if that clause of Section 203 (a) (2), quoted above, left any doubt as to the insurance company's right to deduct such reserves as we are here concerned with, it seems that that doubt was resolved in conformity with our contentions by the further clauses in the same Section, allowing the deduction of the reserves already mentioned "plus (in case of life insurance companies issuing policies covering life, health, and accident insurance combined in one policy issued on the weekly premium payment plan, continuing for life and not subject to cancellation) 4 per centum of the mean of such reserve funds (not required by law) held at the beginning and end of the taxable year, as the Commissioner finds to be necessary for the protection of the holders of such policies only." This is another definite statement of Congress that some reserve funds may be de-

ductible even though they cover an obligation maturing before death. But even more clearly than that, it indicates that the purpose of Congress was to permit the deduction of such reserve funds required by law as are "necessary for the protection" of the policyholders. The policyholders are just as obviously in need of protection with respect to the survivorship investment benefits as they are with respect to death benefits, endowment benefits, cash surrender value, loan value, or any other right which they may possess under their policies.

Near the end of its opinion filed herein, this Court, speaking of life insurance liability, said:

> "Ascertainment of the reserves attributable to that liability involves consideration of the amount contributed to them out of premiums plus interest for a period *estimated* on the basis of *mortality.*" (Italics are ours.)

As above indicated, the purpose of the reserves is protection of the policyholders and the manifest purpose of Congress in allowing the deduction of a portion of the reserves is to allow the deduction of the reserves required for such protection. Some of the liabilities under the insurance policy mature upon the death of the policyholder. Inasmuch as the date of death cannot be accurately foretold and it is impossible to determine with absolute certainty how large a fund is necessary for the protection of the policyholder, it becomes necessary to resort to an *estimate.* Likewise, because of man's lack of prescience this estimate must be on the basis of *mortality.* The use of estimates and the resort to mortality tables in making those estimates result only from our human limitations and our inability to determine with greater certainty exactly when this particular liability will mature and, consequently, what reserve must be established to meet it at maturity.

It is evident therefore that estimates based upon mor-

tality are only means to an end—that end being the determination of the amount necessary for the protection of the policyholder, which in turn depends upon the time when the obligation will mature. If that end can be achieved by some other means (as it of course can with respect to insurance obligations maturing upon a fixed future date), there can be no need of resorting to estimates. When it is said that the end contemplated by the Statute has not been achieved because it was reached by a different means—even though that means may be far better, because more accurate, than the estimate ordinarily employed to determine the amount required to be reserved with respect to liabilities maturing at an uncertain date in the future—the conclusion is, in our opinion, fallacious.

Conclusion.

For the foregoing reasons it is respectfully urged that this petition for a rehearing be granted, and that upon further consideration the judgment of the Circuit Court of Appeals for the Seventh Circuit be affirmed.

Respectfully submitted,

Roy O. West,
Percy B. Eckhart,
William M. Klein,
Samuel B. Kraus,
Attorneys for Respondent.

I, Samuel B. Kraus, one of the attorneys for the above-named respondent, Illinois Life Insurance Company, do hereby certify that the foregoing petition for a rehearing of this cause is presented in good faith and not for delay.

Samuel B. Kraus,
Attorney for Respondent.

P. 1

SUPREME COURT OF THE UNITED STATES.

No. 27.—October Term, 1936.

Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *vs.* Illinois Life Insurance Company.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit.

[November 9, 1936.]

Mr. Justice Butler delivered the opinion of the Court.

In its income tax return for 1929, respondent made a deduction of $133,755.71. The Board of Tax Appeals held the deduction rightly taken, 30 B. T. A. 1160, 1162; the Circuit Court of Appeals affirmed. 80 F. (2d) 280. Upon petitioner's insistence that the decision below conflicts with *Helvering* v. *Insurance Co.*, 294 U. S. 686, we granted this writ.

The case involves a construction of a clause of § 203 (a) (2), Revenue Act of 1928, 45 Stat. 842, which declares that, in case of a life insurance company, net income means gross income less, among other permissible deductions, an amount equal to four per cent of the mean of the reserve funds required by law and held at the beginning and end of the taxable year. That provision is a reenactment of § 245 (a) (2), Revenue Act of 1921, which in *Helvering* v. *Insurance Co.* we held not to apply to assets reserved by a life insurance company against matured, unsurrendered and unpaid coupons attached to its policies. That decision rests upon the ground that the reserves in respect of the coupon liability were not essentially insurance reserves which alone constitute the base on which deduction is computed. The question now for decision is whether respondent's assets reserved in 1929 in respect of its survivorship investment funds are included in that base.

The reserves in question conveniently may be described by reference to a typical policy. Applicable to age 35, it contains the

company's agreement, upon death of the insured, to pay $10,000 to the beneficiary; the annual premium is $379.90, payable for 20 years. The company also agrees that, out of each year's premium after the first, $64.60 will be placed in the survivorship investment fund applicable to policies on the survivorship investment plan issued in the same calendar year; that no deduction shall be made from the fund; that all contributions to it shall be accumulated at three and a half per cent compound interest; that, if the insured shall survive the twentieth anniversary of the policy, the company will apportion to the policy as a survivorship investment a sum bearing the same proportion to the total in the fund as the contributions from premiums paid on that policy bear to the aggregate contributions from premiums paid on all policies in the same class in force at the end of 20 years. Thus, the entire fund is divided among the persistent surviving contributors. The policy provides for optional settlements at the end of 20 years: (A) The insured may continue the policy as one fully paid up and in addition receive either cash payment of the survivorship investment apportioned to it or, if then insurable, a fully paid up life insurance policy for such amount as would be purchased by the survivorship investment. (B) The insured may surrender the policy and receive payment of the cash value, $6,100, and in addition the survivorship investment.

The mean of petitioner's liabilities in respect of the survivorship investment funds at the beginning and end of 1929 was $3,343,982.67, four per cent of which is the item in controversy.

The phrase "required by law" includes only reserves that directly pertain to life insurance. Other reserves, even though required by state statutes regulatory of the business authorized to be carried on by life insurance companies, are not included. Under these policies the company's liabilities on account of the investment funds are independent of those attributable to life insurance risks. The right to participate in the investment funds is not dependent upon death of the insured. The company's liability is the total of contributions to the fund plus the interest agreed to be paid. It is bound to discharge this liability at the end of 20 years. Its life insurance liability arises upon the death of the insured. Ascertainment of the reserves attributable to that liability involves consideration of the amount contributed to them out of premiums plus

interest for a period estimated on the basis of mortality.[1] The survivorship investment fund feature of these policies has no relation to life insurance risks. Under our decision in *Helvering* v. *Insurance Co., supra,* reserves in respect of that feature are not covered.

Reversed.

A true copy.

Test:

Clerk, Supreme Court, U. S.

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[1] The laws of Illinois, under which respondent was organized, declares: "All valuations made by it [the Department of Trade and Commerce] or by its authority shall be made upon the net premium basis. The legal minimum standard for valuation of contracts . . . shall be the American Experience Table of Mortality with interest at 3½ per centum per annum." Cahill's Illinois Revised Statutes (1929), c. 73, par. 331.

It is also declared: " . . . that if any company shall issue any non-participating policy under the terms of which any stipulated part of premiums received is to be placed in a separate fund for subsequent apportionment, such company shall furnish the Department of Trade and Commerce each year . . . a statement" concerning the fund so provided for "and the amount of said fund at the end of the year; which shall be carried as a distinct and separate reserve liability of the company for the benefit of the classes of policies from the premium payments on which the sum was accumulated. No part of said fund prior to the time of distribution stipulated in the contract shall be considered in determining the loan and cash and other surrender values provided for by this Act. . . . No such policy shall be issued which by its terms shall provide that more than twenty-five per cent of the annual premium shall be placed in such fund. . . ." Idem, par. 375, § 5-c.